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IN THE

Supreme Court of the United States

OCTOBER 1979 TERM

D. DOYLE MIZE and FARNHAM CORPORATION,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

1. May the Court of Appeals reverse a district court judgment favorable to defendants in an SEC injunctive action, rendering judgment against defendants on the issue of violations of the securities laws, even though defendants have not had an opportunity to present their evidence?

2. May the Court of Appeals find allegedly undisclosed information to be material as a matter of law under the securities statutes, even though defendants have not had an opportunity to present their evidence?

3. Does the opinion of the panel below conflict with this Court's recent decision in *Aaron* v. *SEC*, since the panel found that the failure to disclose allegedly material information was a *per se* securities violation, without any finding or suggestion of scienter?

4. In reviewing a trial court judgement in an SEC injunctive action where the proper legal standard has been applied, may the Court of Appeals set aside fact findings not found to be clearly erroneous, and reverse and render in part absent a finding of an abuse of discretion?

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OPINIONS BELOW

The Judgment, Findings of Fact and Conclusion of Law of the United States District Court for the Southern District of Texas were not published in any reporter, but are reproduced herein as Appendix "A".

The opinion of the panel of the United States Court of Appeals for the Fifth Circuit is reported at 615 F. 2d 1046, and is reproduced herein as Appendix "B".

JURISDICTIONAL STATEMENT

The jurisdiction of this Court is proper under 28 U.S.C. §1254(1), and the case is appropriate for review on certiorari under Supreme Court Rule 17.1(a) and (c). The Court of Appeals' decision has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. Further, the Court of Appeals has decided a federal question in conflict with applicable decisions of this Court, most noticeably: *Aaron* v. *SEC*, — U.S. —, 48 U.S.L.W. 4609 (1980); *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976); *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100 (1969); and *Saunders* v. *Shaw*, 244 U.S. 317 (1917). The Court of Appeals decision is further in conflict with decisions of other Courts of Appeal, including *SEC* v. *Bausch & Lamb, Inc.*, 565 F.2d 8 (2nd Cir. 1977), and *Rogen* v. *Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966). The effect of this decision, if not reviewed, will be to produce non-uniform and uncertain application of the federal securities laws in important respects.

The Court of Appeals decision sought to be reviewed herein was dated and entered on April 23, 1980. An Order denying rehearing *en banc* was entered on May 21, 1980. Accordingly, the instant Petition is timely pursuant to 28 U.S.C. §2101(c) and Supreme Court Rule 20.4.

STATUTES AND RULES INVOLVED

Sections 17(a), 20(b), 20(c) and 22(a) of the 1933 Securities Act, 15 U.S.C. §§77q(a), 77t(b), 77t(c) and 77v(a); Sections 10(b), 14(d), 14(e), 21(d), 21(e) and 27 of the Securities and Exchange Act of 1934, 15 U.S.C. §§78j(b), 78n(d), 78n(e), 78u(d), 78u(e) and 78aa; Rules 10b-5 and 14d-1 thereunder, 17 C.F.R. 240.10b-5 and 240.14d-1; and Fed. R. Civ. P. 52(a) are set out in full in Appendix "C".

STATEMENT OF THE CASE[1]

This action was initiated by the Securities and Exchange Commission (SEC) in the United States District Court for the Southern District of Texas. Alleging violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a); Sections 10(b), 14(d) and 14(e) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b), §78n(d) and §78n(e) and Rules 10b-5 and 14d-1 thereunder, 17 C.F.R. 240.10b-5 and 240.14d-1, the SEC sought a permanent injunction against defendants D. Doyle Mize and the Farnham Corporation and against other defendants no longer parties to the case. Mize was chief executive officer of Southdown, Inc., from 1969 to March 27, 1975, when he became chief executive officer of Valhi, Inc. Valhi had been a wholly-owned subsidiary of Southdown, but was subsequently spun-off in a stock dividend to the common shareholders of Southdown. The Farnham Corporation was formed in July, 1975, by Mize and others for the purpose of making a counter-tender offer for Valhi stock (to be discussed below).

The underlying facts involve a series of corporate ideas and transactions. Southdown, was a conglomerate corporation with subsidiaries involved in widely divergent businesses. The Valhi subsidiary (and its predecessor, Southdown Land Company) was

[1] This statement is derived solely from the evidence adduced at trial by the SEC, since, as will be noted throughout this Petition, Defendants-Petitioners have not had an opportunity to present their defenses or evidence.

engaged in large-scale agricultural operations and land development.

As early as 1971, the board of directors of Southdown recognized that substantial benefits for Southdown, its agricultural subsidiary, and its shareholders, could be realized by a separation of Southdown from its agricultural subsidiary. Accordingly, Southdown's directors and management began exploring means to accomplish such separation. The aim was the division of Southdown and its agricultural subsidiary into two distinct entities having different operating characteristics and capital structures. At all pertinent times, the advice of capable and experienced outside legal counsel and financial advisors was sought and followed by Southdown's officers, particularly defendant-Petitioner Mize.

On March 27, 1975, Southdown's board of directors unanimously approved the spin-off of Valhi from Southdown, to be accomplished by the distribution of a stock dividend to Southdown's common shareholders of one share of Valhi common stock for each six shares of Southdown's common stock. On May 28, 1975, the spin-off was consummated by distribution of the Valhi stock dividend to Southdown common shareholders of the record date of May 13, 1975.[2] In July, 1975, a tender offer for Valhi stock was made by Contran Corporation, a Dallas-based investment firm totally unrelated to Petitioners. Thereafter, Farnham Corporation was organized and made a counter-tender offer for Valhi stock. Ultimately, the Contran tender offer was successful and Contran gained control of Valhi.

The SEC alleged that material matters were misrepresented or not disclosed, in violation of several securities statutes, with regard to Southdown's amendments (filed April 25, 1975) to its annual 10-K and Farnham's schedule 13-D and tender offer

[2] Defendants-Petitioners received no shares of Valhi stock because they were not common shareholders of Southdown.

materials (and amendments thereto) mailed to Valhi shareholders.[3]

The SEC alleged that certain ideas and proposals, none of which were consummated, were material, requiring disclosure under the securities statutes. The matters which the SEC contended should have been disclosed relate to ideas discussed during two abandoned transactions: (1) the Lambert Freres & Cie. tender offer proposal[4] and (2) embryonic negotiations involving Valhi, one Charles Peterson, and National Alfalfa Dehydrating & Milling Company (a publicly held corporation).

The Peterson proposal. Since the fall of 1974, Southdown had had an interest in acquiring the 51% bloc of stock in National Alfalfa Dehydrating & Milling Company owned by Mr. Charles Peterson. Some preliminary negotiations occurred but were abandoned. After the Valhi spin-off had been approved by the Southdown board of directors and after Mize's resignation, Petitioner Mize started to work on a proposal whereby his employer Valhi might acquire 100% of the stock of National Alfalfa. The stock owned by Peterson was pledged to secure a debt of $7,000,000.00. In April, 1975, Mize prepared a memorandum (entitled "Valhi/NA/CP") outlining a possible course of action whereby Valhi might acquire Peterson's National Alfalfa stock and a corporation to be formed by Mize and others might obtain financing to retire Peterson's indebtedness. The memorandum proposal was discussed by Mize and Peterson on April 15, 1975, but no agreement between them was ever reached. Peterson made it clear to Mize that although he

[3] Petitioners would point out that the Southdown filings alleged by the SEC and found by the Court of Appeals to omit material information were published *after* Petitioner Mize had resigned from the Southdown board of directors.

[4] An extended discussion of the Lambert matter is not necessary in this Petition, since the Fifth Circuit opinion of which review is herein sought affirmed the trial court's holding that certain matters pertaining to the Lambert proposal were not material and therefore not required to be disclosed.

was interested in the prospect of effectuating the ideas sketched out in the memorandum, he would continue pursuing other buyers for his stock, since the indebtedness it was pledged to secure was to mature at the end of the year. On April 25, 1975, Mize and Richard and Leland McCarthy (the latter two brothers being operating principals of the agricultural subsidiary) met with representatives of a California bank to inquire whether the bank might be interested in lending Farnham Corporation $7,000,000.00 to be used in connection with the possible acquisition by Valhi of Peterson's National Alfalfa stock. The bank representatives informed Mize and his colleagues that the bank perceived many problems with such a transaction, but would investigate it further. On May 13, 1975, the bank officers notified Mize that the bank would approve the loan provided all other aspects of the Valhi/NA/CP memorandum could be finalized. Two days later (*i.e.*, May 15, 1975) an action was commenced in federal court in Houston by Southdown shareholders, seeking to enjoin the Valhi spin-off. A temporary restraining order was entered the day the suit was filed. In view of these developments, Mize concluded on May 15, 1975, that the ideas embodied in the Valhi/NA/CP memorandum were no longer viable, and on that day he laid those ideas to permanent rest. The temporary restraining order was later dissolved, and the Valhi spin-off was consummated on May 28, 1975.

In the instant case, upon trial to the court, Judge O'Conor of the Southern District of Texas granted defendants' motion for judgment, made at the conclusion of the SEC's case-in-chief, on October 18, 1977, prior to Defendants having been afforded an opportunity to present their case. Judge O'Conor issued Findings of Fact and Conclusions of Law, filed on October 27, 1977, to the effect that the proposals outlined above had not reached a sufficient level of maturity to be material, and therefore were not required to be disclosed; Defendants-Petitioners had not engaged in past violations of the securities statutes; and that there was no

reasonable likelihood of future violations of the securities laws. Accordingly, he entered judgment denying the SEC an injunction.

The SEC took an appeal to a panel of the United States Court of Appeals for the Fifth Circuit, which issued its opinion on April 23, 1980. The opinion did not reverse the trial court's denial of injunctive relief and render judgment for an injunction; did not find the trial court had abused its discretion nor that its findings were clearly erroneous; and explicitly held that the trial court *had* applied the proper legal standard of materiality to the facts of the case. However, the opinion concluded "the balance in this case tips in favor of materiality" (as to the Peterson proposal only). On that basis the panel substituted its finding that there had been past violations of the securities statutes for the trial court's contrary findings and remanded the case for reconsideration of the issue of the likelihood of future violations. There was no finding or suggestion of scienter in the panel's opinion. Petitioners timely perfected a motion for rehearing *en banc*, but it was denied on May 21, 1980.[5]

ARGUMENT

The decision and disposition of this case by the Court of Appeals represents a marked departure from solidly established principles concerning the proper function of a federal appellate court in reviewing a judgment in a non-jury trial. Furthermore, the opinion below displays a rationale wholly in conflict with this Court's decisions in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), and in *Aaron* v. *SEC*, -- U.S. --, 48 U.S.L.W. 4609 (No. 79-66, June 2, 1980). Petitioners will demonstrate

[5] The district court's jurisdiction was proper under 28 U.S.C. § 1331, 15 U.S.C. § 77v(a) and 15 U.S.C. § 78aa. Jurisdiction in the Court of Appeals was founded on 28 U.S.C. § 1291. Supreme Court jurisdiction is proper under 28 U.S.C. § 1254(1) and the case is an appropriate one for review here on certiorari under Rule 17.1(a) and (c) of the Rules of the Supreme Court of the United States.

that the errors complained of, as to both substantive federal securities law and the proper scope of appellate review, are serious enough to warrant either summary per curiam reversal of the opinion below or full briefing and hearing of the case.

1. *Adverse determination prior to opportunity to present evidence.*

The Fifth Circuit panel in the case at bar reversed the trial court judgment in a most unorthodox fashion. In so doing, it produced a result squarely in conflict with this Court's decision in *Saunders* v. *Shaw*, 244 U.S. 317 (1917), which held that a party against whom an adverse appellate finding had been made without an opportunity to present its evidence at trial had been denied due process of law.[6]

The panel in the instant case considered the trial court's carefully determined finding that the Peterson proposal had not reached a sufficient level of maturity to be material for purposes of disclosure under the pertinent securities statutes. It then undertook to reverse that finding, substituting and rendering *sua sponte* a contrary finding that the Peterson matter was material and that its nondisclosure constituted a violation of the securities statutes.[7] As will be seen hereinbelow, the panel did so in stark contravention of voluminous case law emanating from this Court

[6] *Saunders* continues to have vitality. In 1935, this Court relied on *Saunders* in a similar case, *Georgia Railway & Electric Co.* v. *City of Decatur*, 275 U.S. 165. There, a state statute required street railroad companies complaining of municipal assessments for street inprovements to prove that they did not benefit from the improvements. When the state court refused to allow the railroad companies to make such proof, this Court held such refusal a denial of due process. *Saunders* has been applied by this Court as recently as *Hamling* v. *United States*, 418 U.S. 87, 110 n.11 (1974).

[7] The Fifth Circuit's procedural disposition of this case was at odds even with what had been requested by the SEC on appeal. The relief sought by the SEC was a remand of the entire case to the district court. SEC Brief at 40; SEC Reply Brief at 15. Therefore, the Fifth Circuit acted *sua sponte* in its novel partial rendition of judgment against Petitioners.

and from the Courts of Appeal, and the crystal clear provisions of Fed.R.Civ.P. 52(a). That would have been an egregious injustice even on the basis of a fully developed record. However, the panel further compounded its error by holding as it did — that the undisclosed matters were material, as a matter of law, and that a violation of the securities laws had occurred — even though Petitioners-Defendants had not had an opportunity to put on their case in the trial court. By virtue of this Court's teaching in *Saunders*, *supra*, the Court of Appeals' error was not merely one of appellate procedure, but was a violation of Petitioners' right to due process. If allowed to stand, the panel's decision will have the effect of depriving Petitioners of any forum in which to present their defenses and evidence on the issue of past violations of the securities laws.

In the trial of this case before the district court, Petitioners-Defendants moved for dismissal at the close of the SEC's case-in-chief. The trial court, determining that the SEC's evidence had failed to establish either past violations or a reasonable likelihood of future violations, granted the motion. Thus, there was neither opportunity nor need for defendants below to present their defense and no record was built in support of that defense.[8]

[8] In this connection, Petitioners deem it significant to point out to the Court that their counsel intended to call *seventeen* witnesses in their behalf, whose testimony, Petitioners submit, would have even more conclusively established that Petitioners had neither violated the securities law nor were likely to do so in the future. Furthermore, there were numerous defensive issues raised in Defendants-Petitioners' pleadings which were never aired and which were crucially relevant to the question of whether past violations had occurred. Had it been necessary for them to present their case to the trial court, Defendants' witnesses would have testified with regard to such crucial issues as whether there had been a purchase or sale of securities in the matters complained of by the SEC and, if so, whether Defendants' conduct had been "in connection with" such purchase or sale of securities; Defendants' intent in the matters at issue, especially whether there was any fraudulent or manipulative intent; and the effect of disclosures made in other media than in the filings and documents alleged by the SEC to be materially misleading. Since there was no need for Defendants to present their case, the

It was on this incomplete, one-sided record that the Fifth Circuit held that, as a matter of law, the Peterson proposal was material and that its nondisclosure amounted to a *per se* securities violation. Petitioners submit that under the most elementary principles of fair play and substantial justice, this fundamentally unfair result cannot be allowed to stand unreviewed by this Court. If uncorrected by this Court, the Fifth Circuit will have reversed and rendered a crucial finding on which the Defendants-Petitioners have not had their day in court. Moreover, it will have done so in conflict with an applicable constitutional decision of this Court — *i.e., Saunders, supra.*

The denial to Defendants in any SEC injunctive action of an opportunity to present their defense should be a matter of grave concern to this Court. An SEC injunction is a drastic remedy in the modern-day business world, no longer considered merely a "mild prophylactic." See *Aaron* v. *SEC,* -- U.S. --, 48 U.S.L.W. 4609, 4615-16 (1980) (Burger, C.J., concurring). The denial to Defendants of an opportunity to present their case assumes an even more disturbing and prejudicial aspect in this case. The question of past violations may be the determinative issue in a pending corporate derivative action against Petitioner Mize, involving, *inter alia,* many of the same issues of fact and law involved in this case. *Southdown, Inc.* v. *Mize* (Civil No. 75-H-728, in the United States District Court for the Southern District of Texas, Houston Division). If the rule of *Parklane Hosiery, Co., Inc.* v. *Shore,* -- U.S. --, 99 S.Ct. 645 (1979), is applicable, Petitioner may be collaterally estopped from litigating the issue of past violations in the pending related case. Thus, Defendants-Petitioners have not had the opportunity, and if collaterally estopped, *will never have the opportunity,* to put on their case, which would have demonstrated even more conclusively that there had been no violations of the securities laws.

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record fails to adequately develop and illuminate these issues, which are consequently either not discussed or discussed only in the most cursory fashion in the Court of Appeals' opinion.

The trial court which determined the issue of materiality in favor of Defendants-Petitioners, had before it the testimony of at least the SEC's live witnesses. If the Fifth Circuit opinion is allowed to stand, this crucial issue will have been reversed by an appellate court, on a record devoid of the defenses and evidence Defendants-Petitioners would have presented. Petitioners submit that this state of affairs requires that this Court vacate the Court of Appeals decision and affirm the trial court judgment, or at least remand the entire case to the trial court.

2. *Materiality as a matter of law.*

The Court of Appeals decision is in conflict with applicable decisions of this Court and other Courts of Appeals in its finding of materiality as a matter of law.[9] This Court has made it clear, however, that the question of materiality is a mixed question of fact and law, to be resolved by the trier of fact. *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976).[10] This point also finds clear support in case law from the various Courts of Appeals. *E.g., SEC* v. *Bausch & Lomb, Inc.*, 565 F.2d 8 (2d Cir.

[9] The Court of Appeals opinion does not state *in haec verba* that it is finding materiality as a matter of law in this case. However, that is clearly the impact of its finding. The panel orders that upon remand, the issue of the likelihood of future violations is to be reconsidered in light of the panel's substituted finding that past violations did occur. 615 F.2d at 1055. Upon remand, Petitioners are to be denied any opportunity to contest the issue of past violations, which is not to be reconsidered by the trial court. Therefore, though not explicitly denominated as such, the Court of Appeals' finding of materiality is clearly in substance a finding as a matter of law.

[10] In *TSC Industries*, this Court held materiality under Section 14(a) of the Securities and Exchange Act of 1934 and SEC Rule 14a-9 to be a mixed issue of fact and law. The instant case does not involve that statute and rule, but, rather, Section 17(a) of the Securities Act of 1933, Sections 10(b), 14(d) and 14(e) of the 1934 Act, and Rules 10b-5 and 14d-1 thereunder. All of these antifraud statutes and rules have a similar import, and the Court recognized the similarity in the concepts of materiality embodied in them. *TSC Industries, supra*, at 446 n.8.

1977); *Rogen* v. *Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966). Only where reasonable minds could not possibly differ on the question of materiality should it be found as a matter of law. *James* v. *Gerber Products Co.*, 587 F.2d 324 (6th Cir. 1978). Clearly, that is not the situation presented in the instant case, even under the view of the Fifth Circuit panel. Far from trumpeting an indisputable matter-of-law holding, the Fifth Circuit panel instead undertook a weighing of the SEC's evidence on the issue of materiality and concluded: "[W]e believe the balance in this case tips in favor of materiality." 615 F.2d at 1054.[11] The panel thus accomplished an entirely illogical and self-contradictory feat: while recognizing that reasonable minds could differ in determination of the materiality issue in this case,[12] it nonetheless proceeded to decide that issue adversely to Petitioners as a matter of law. Such a blatant conflict with this Court's analysis in *TSC Industries* of materiality and how it is to be determined requires review by this Court.

3. *Conflict with* Aaron v. SEC.

Petitioners also seek review of the opinion below because it conflicts with this Court's recent, intervening decision in *Aaron*

[11] It is noteworthy that even in the SEC's own case, there was ample evidence, as recognized by the panel below, pointing toward the conclusion that the allegedly undisclosed matters concerning the abandoned Peterson proposal would not have been material to the deliberations of a reasonable investor. For instance, by May 28, 1975, the first date on which a Southdown common shareholder would have become a Valhi common shareholder under the spin-off, the Peterson proposal had been totally *abandoned* for almost two weeks (since May 15). Certainly reasonable minds could differ as to what significance, if any, the reasonable investor would attach to an irrevocably abandoned proposal in making an investment decision concerning Valhi stock. Indeed, the SEC's evidence failed to convince the trial judge that such an abandoned idea would have been material in the mind of a reasonable investor deliberating a Valhi investment decision after May 28.

[12] This is established by the opinion's need to weigh the evidence and to determine in which direction "the balance tips" on the issue of materiality.

v. *SEC*, -- U.S. --, 48 U.S.L.W. 4609 (No. 79-66, June 2, 1980). Under the Fifth Circuit's analysis in the instant case, a mere finding that undisclosed information was material, with nothing more, triggers an automatic finding that there was a violation of the securities statutes. 615 F.2d 1054-55. Nowhere in the opinion is there the slightest discussion of Petitioner's state of mind and intent in allegedly not disclosing the matter deemed by the panel to be material. Not only is there no finding of a knowing intent to employ any scheme, or artifice to defraud or any manipulative or deceptive device, there is not even a finding of negligence in relation to the non-disclosure. These questions were not even reached by the Fifth Circuit panel. Rather, it took the simplistic and mechanical approach that non-disclosure of material information constitutes a *per se* securities violation. If such a reading of Section 10(b) of the 1934 Act, Rule 10b-5, and Section 17(a)(1) of the 1933 Act ever had any viability, it clearly does not now in light of this Court's opinion in *Aaron* v. *SEC, supra.*[13]

Aaron establishes that the SEC in an injunctive action under Section 10(b), Rule 10b-5, and Section 17(a)(1) must prove scienter as an element of its prima facie case. Defendants-Petitioners' case, had it been presented to the trial court, would have forcefully established a lack of fraudulent, deceptive, or manipulative scienter. Rather, as indicated by the SEC's own evidence and as would have been greatly amplified by Defendants' evidence if presented, Petitioner Mize's non-disclosure was the decision of a prudent, experienced businessman who had for years made a meticulous habit of consulting sophisticated legal counsel on all matters touching on the securities law. There simply was not, and could not be, any evidence of scienter as required by *Aaron* as an essential element of the SEC's case. Thus, it is not too surprising that the Fifth Circuit failed

[13] The Court of Appeals' opinion in the case at bar was issued on April 23. This Court decided *Aaron* on June 2.

altogether to reach this crucial issue. The reasoning of *Aaron* and the reasoning of the opinion below are poles apart: even if the panel's finding of materiality is accepted as correct,[14] that alone, particularly in light of Petitioners' lack of opportunity to present their defenses and evidence, is far from sufficient to determine that Petitioners had violated Section 10(b), Rule 10b-5, and Section 17(a)(1). *Aaron* teaches that there can be no violation of these Sections in the absence of scienter, and there has been no finding of scienter by any court in this case. To allow the opinion below to stand would cast serious doubt on whether the *Aaron* decision is to have any force in the courts of the Fifth Circuit.

4. *Appellate review errors.*

The procedural aspects of the Court of Appeals opinion also require review and reversal by this Court. The opinion reversed the district court's judgment denying the SEC an injunction without any finding or suggestion of an abuse of discretion by the trial court; substituted a contrary fact finding (that Petitioners had committed a violation of the securities statutes) for the trial court's, although it expressly held that the trial court had applied the proper legal standard to the facts and did not find the trial court's findings to be clearly erroneous; and remanded the case for consideration of the likelihood of future violations in light of its substituted finding of past violations. This was done even though, as noted, Petitioners had not presented their evidence to the trial court. Both the reasoning and the result of the opinion do violence to established principles of law.

That whether an injunction will issue rests within the sound discretion of the trial court and that the trial court's exercise of such discretion will not be disturbed on appeal unless there has

[14] Such a finding is, of course, squarely at odds with the finding of the trial judge who heard and evaluated all the evidence brought forward by the SEC. District Court Findings of Fact Nos. 15, 16 and 18, Appendix at A-5.

been an abuse of discretion are points so firmly ingrained in our jurisprudence that they should not require citation of authorities. However, for present purposes, some prominent, relevant authorities for these propositions in SEC injunction actions include *SEC* v. *Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972) and *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied* 394 U.S. 976 (1969). Yet, the Fifth Circuit in the case at bar displayed a rationale wholly in conflict with these settled principles.

Nowhere in the opinion is there the faintest suggestion that the district court abused its discretion in denying the SEC's requested injunction. Rather, the Court of Appeals elected to engage in rewriting the district court's findings, although it explicitly stated that the trial court had *not* applied an erroneous legal standard to the facts of the case,[15] as had been contended by the SEC on appeal.

The opinion's analysis of the trial court's findings of fact displays an egregious failure to conform to the mandates of Fed. R. Civ. P. 52(a) and is in conflict with numerous cases construing that Rule. The Rule provides, in pertinent part, with respect to non-jury or advisory-jury cases: "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." There is a clear body of caselaw delineating the proper scope of appellate review under the Rule. The Court of Appeals is not to choose between conflicting theories but is to make certain the theory accepted by the district court has sufficient evidentiary support and that its fact findings are not clearly erroneous. *E.g.*, *Beltronics, Inc.* v. *Eberline Instrument Corp.*, 509 F.2d 1316 (10th Cir. 1974), *cert. denied* 421 U.S. 1000; *Moorehead Construction Co., Inc.* v. *City of Grand Forks,*

[15] "[A]lthough we disagree with the district court's conclusions regarding the Peterson deal, we do not believe the court applied an erroneous legal standard to the facts in this case." 615 F.2d at 1055.

508 F.2d 1008 (8th Cir. 1975). This is a matter to which this Court has had occasion to address itself several times through the years, and its holdings make clear that the Court of Appeals self-appointed fact finding in this case was unwarranted.

In *United States* v. *National Association of Real Estate Boards*, 339 U.S. 485 (1950), Justice Douglas, writing for the Court, stated:

> It is not enough that we might give the facts another construction, resolve the ambiguities differently, and find a more sinister cast to actions which the District Court apparently deemed innocent . . . (citations omitted). We are not given those choices, because our mandate is not to set aside findings of fact "unless clearly erroneous."

Id. at 495. Clear guidance on this matter is also found in *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969) and *United States* v. *Yellow Cab Co.*, 338 U.S. 338 (1949). There is a glaring conflict between this Court's teachings on appellate review as expostulated in those cases and the Fifth Circuit's utter disregard in this case of its limited appellate function in reviewing non-jury findings.

Against the universally adopted principle that fact finding is the province of the trial, rather than appellate, court, the Court of Appeals panel in the case at bar substituted its own findings for Findings of Fact numbers 15, 16 and 18. The trial court findings were to the effect that the Peterson proposal represented mere *ideas* and not final plans, and therefore there was not sufficient materiality to require disclosure under the pertinent securities statutes. In disturbing these findings, the Court of Appeals did *not* measure the findings against the standard of Rule 52(a) and find them to be clearly erroneous. Rather, it engaged in a reweighing of the inferences pro and con that could be drawn from the facts pertaining to materiality, concluding:

> After a careful consideration of the record and with due deference to the district court's finding, we believe the balance in this case tips in favor of materiality.

615 F.2d at 1054. The opinion below does not characterize as clearly erroneous the trial court's finding of a lack of materiality. Rather, the opinion merely indicates that if the particular judges on the panel had been confronted with the issue *de novo*, they would have resolved it differently than the trial court did.

The panel's action compels review by this Court, which has stated: "Findings as to the design, motive and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them [*i.e.*, trial court judges]." *Yellow Cab, supra*, at 341. Inherent to the district court's findings that the transactions at issue had not reached a level of maturity as to be deemed material for disclosure purposes was its apparent perception of the basic credibility of Mize, called as a witness by the SEC, and the other SEC witnesses whose testimony supported his. A strong body of case law has developed recognizing the essentially superior position of the trial court in a case of this nature vis-á-vis the appellate court to make credibility determinations regarding witnesses. *E.g., United States* v. *Oregon State Medical Society*, 343 U.S. 326, 339 (1952); *Rare Earth, Inc.* v. *Hoorelbeke*, 401 F.Supp. 26 (S.D.N.Y. 1975). The teaching of these cases was effectively ignored in the opinion below.

Arguably, the findings at issue here involved mixed questions of fact and law rather than pure questions of fact. *TSC Industries, Inc.* v. *Northway Inc., supra.* Determinations in securities litigation of materiality of undisclosed information necessarily entail not only an inquiry into the underlying facts but at least some application of rules of law to those facts. However, the same underpinnings of the clearly erroneous rule with respect to a pure question of fact support the application of the rule to a mixed fact/law question of materiality under the securities statutes. Courts have consistently held the issue of materiality of information to be within the legitimate province of the trier of fact, not to be lightly disturbed on appeal. *SEC* v. *Bausch &*

Lomb, Inc., supra; *Johns Hopkins University* v. *Hutton*, 422 F.2d 1124 (4th Cir. 1970).

Although numerous federal cases hold that the clearly erroneous rule of review is not to be applied where the trial court applied an erroneous legal standard to the facts,[16] that exception to the rule is clearly inapplicable here, even in the view of the Court below. The Court had been urged by the SEC on appeal to find that the district court had applied an incorrect legal standard (of materiality), so that the latter's findings could be reviewed by the Court of Appeals on a less rigorous standard than mandated by the clearly erroneous rule. SEC Brief at 28-33. The Fifth Circuit panel considered this contention and stated:

> In reviewing the district court's decision in this case, we have carefully considered the SEC's argument that the Court failed to apply the accepted standard of materiality. We see no evidence in the record to support this contention. * * * Thus, although we disagree with the district court's conclusions regarding the Peterson deal, *we do not believe the court applied an erroneous legal standard to the facts in this case.*

615 F.2d at 1055 (emphasis added).

In light of these gross appellate errors, Petitioners request that this Court vacate the panel's opinion and affirm the well-supported judgment of the trial court.

CONCLUSION

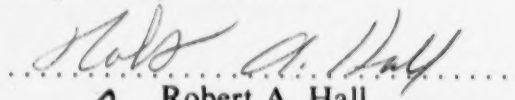
That the Court of Appeals' disposition of this case reflects a substantial deviation from black-letter principles of federal securities laws and appellate jurisprudence in itself justifies review of this case by this Court. However, the denial to Petitioners of fundamental due process by the rendition of a judgment that the securities laws were violated before Petitioners had the opportunity to present their evidence, as well as the intervening *Aaron* opinion, clearly mandates summary reversal

[16] *E.g.*, *Baker* v. *Stuart Broadcasting Co.*, 560 F.2d 389 (8th Cir. 1977).

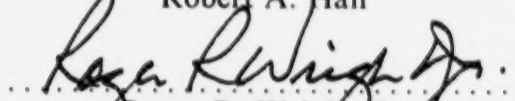
or at least granting of the writ and argument herein. This is especially compelling in view of the potentially far-reaching, damaging collateral effects of the Fifth Circuit opinion on Petitioner Mize, as noted hereinabove.

WHEREFORE, PREMISES CONSIDERED, Petitioners pray that this Court grant this Petition for a Writ of Certiorari; that this Court issue its Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, directing this case to be brought up for review by this Court; and that summarily by per curiam, or upon full review hereof, the decision of the Fifth Circuit be reversed and judgment rendered for Petitioners, or in the alternative, that the Fifth Circuit's decision be vacated and the case be remanded in its entirety for new trial to the United States District Court for the Southern District of Texas, or in the second alternative, that the opinion of the Fifth Circuit be vacated and the case be remanded to that Court for reconsideration in light of *Aaron* v. *SEC*.

Respectfully submitted,



Robert A. Hall



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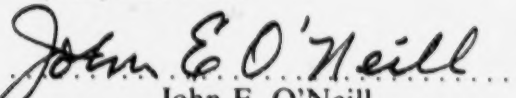

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Attorneys For Petitioners,
D. Doyle Mize and
Farnham Corporation

CERTIFICATE OF SERVICE

We hereby certify that on the 12th day of August, 1980, three copies of the above and foregoing Petition was served upon the Plaintiff's attorney of record by placing same in the United States mail, postage prepaid, sent certified mail, return receipt requested and addressed to Michael K. Wolensky, Associate General Counsel, and Douglas J. Scherdt, Attorney, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, and upon the Solicitor General, Department of Justice, Washington, D.C. 20530.

Robert A. Hall

Roger R. Wright, Jr.

John E. O'Neill

APPENDIX

APPENDIX "A"

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SECURITIES AND EXCHANGE COMMISSION

v.

D. DOYLE MIZE, ET AL

CIVIL ACTION NO. 75-H-1420

FINAL JUDGMENT

On October 17, 1977 came on to be heard the above entitled and numbered cause at which time came the plaintiff, Securities and Exchange Commission, by and through its attorney of record, and came the defendants, D. Doyle Mize and Farnham Corporation and by and through their attorneys of record and all parties announced ready for trial. The plaintiff Securities and Exchange Commission, on October 17, 1977, proceeded to adduce its evidence until it announced in open Court, on October 18, 1977, that it rested. Thereafter the defendants, D. Doyle Mize and Farnham Corporation, made their motion for judgment of dismissal on the merits and having considered said motion and arguments of counsel the Court announced in open Court that the defendants' motion was granted and it is therefore ORDERED, ADJUDGED and DECREED as follows:

I.

The preliminary injunction heretofore entered against the defendants, D. Doyle Mize and Farnham Corporation, in the above entitled and numbered cause is in all things dissolved, set aside and held for naught.

II.

All relief sought by the plaintiff Securities and Exchange Commission in its complaint on file herein is in all things denied, and said cause of action is dismissed.

This is a final judgment.

Signed at Houston, Texas, this 27th day of October, 1977.

/s/ ROBERT O'CONOR, JR.
Robert O'Conor, Jr.
United States District Judge

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

SECURITIES AND EXCHANGE COMMISSION

v.

D. DOYLE MIZE, ET AL

CIVIL ACTION NO. 75-H-1420

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On October 17, 1977 the above entitled and numbered cause came on for trial and came the plaintiff, by and through its attorney of record, and came the defendants D. Doyle Mize and Farnham Corporation, by and through their attorney of record, and all parties announced ready for trial. The plaintiff, on October 17, 1977 proceeded to present its evidence until it rested its case on October 18, 1977. Defendants D. Doyle Mize and Farnham Corporation then made their motion for judgment of dismissal on the merits. The Court having considered said motion and the argument of counsel in connection therewith announced in open Court on October 18, 1977 that the defendants' motion for judgment for dismissal on the merits was granted. The following shall constitute the Findings of Fact and Conclusions of Law of this Court.

FINDINGS OF FACT

1. Defendant, D. Doyle Mize, was Chairman of the Board and Chief Executive Officer of defendant, Southdown, Inc. from March of 1969 until March of 1975.

2. At that time defendant, D. Doyle Mize, became Chairman of the Board of Valhi, Inc. Valhi, Inc. was previously named Southdown Land Co., a wholly owned subsidiary of Southdown, Inc.

3. Southdown, Inc. consisted of various subsidiaries which were involved in the oil and gas, brewing, cement, and farming industries.

4. Southdown Land Co. (Valhi) was formed in July of 1971 with Southdown, Inc. owning 83% of the stock and Richard and Leland McCarthy owning the other 17%. Southdown Land Co. was designed for the purpose of developing land.

5. Except for Southdown Land Co., all of Southdown, Inc.'s other subsidiaries had positive cash flows. Defendant, D. Doyle Mize, believed that Southdown Land Co. was depressing the price of Southdown, Inc. stock. Therefore, in 1972, defendant came up with the idea of spinning off Southdown Land Co. Various ideas were subsequently pursued and later abandoned.

6. On November 18, 1974 Lambert Freres and Co. through its representative Mr. Henry Gittes contacted defendant, D. Doyle Mize, about a possible tender offer for Southdown, Inc.

7. Subsequent discussions followed this initial contact and resulted in the letter of January 23, 1975 from Mr. Lambert to Mr. Mize (Plaintiff's Exhibit 81).

8. Said letter was a proposal which could only be viewed as an idea or conception at that time. As set out in the letter, further investigation and analysis of Southdown, Inc. was necessary before any decision could be made as to whether or not an offer of this type would be rejected by the board of directors of Southdown, Inc.

9. On January 24, 1975, Southdown, Inc. issued a press release (Plaintiff's Exhibit 76) which explained to the public that Southdown, Inc. was cooperating with a foreign entity in conducting a corporate and financial review of Southdown, Inc. so that the foreign entity could proceed with a cash tender offer.

10. Defendant, D. Doyle Mize, acting on counsel's advice, did not include the information contained in the fifth, sixth and seventh paragraphs of Plaintiff's Exhibit 81 (the letter) in the press release.

11. Insofar as there never was a plan but only an idea between defendant, D. Doyle Mize, Richard and Leland

McCarthy and Lambert Freres, and insofar as these matters did not constitute material facts, the press release could not be determined to be false and misleading.

12. Defendant, D. Doyle Mize, continued to explore various ways to realize his desire to spin-off Southdown Land Co.

13. Another idea or proposal was also developed in late 1974 and 1975 involving Mr. Charles Peterson, majority owner of National Alfalfa Dehydrating and Milling Co. (National Alfalfa).

14. This idea involved Valhi, Inc. buying Mr. Peterson's stock in National Alfalfa, a cash tender offer for the outstanding stock, and a merger of National Alfalfa and Valhi.

15. Again, this Court concludes that these were merely ideas and not a final plan because these negotiations had not reached a stage of development or maturity so as to require disclosure.

16. Since no plan actually existed the registration statement of Valhi, Inc. (Plaintiff's Exhibit 181), the prospectus for Valhi, Inc. (Plaintiff's Exhibit 135), and the Amendment on Form 8 to the Annual Report on Form 10-K of Southdown, Inc. (Plaintiff's Exhibit 120) were not materially false and misleading.

17. Farnham, Inc. was formed by defendants, D. Doyle Mize and Richard and Leland McCarthy.

18. Since none of these ideas were a scheme or plan by defendants, D. Doyle Mize and Richard and Leland McCarthy to obtain a controlling block of voting shares of Valhi, Inc. at prices substantially below their book value, the offering materials including the Schedule 13-D used in connection with the tender offer of Farnham, Inc. for securities of Valhi, Inc. were not materially false and misleading.

19. There is no reasonable expectation that Mize or Farnham Corp. will violate, in the future, the securities law of the United States.

CONCLUSIONS OF LAW

1. This Court has jurisdiction of this action pursuant to Section 22(a) of the Securities Act of 1933 (15 USC77v[a]) and Section 27 of the Securities Exchange Act of 1934 (15 USC 78aa).

2. Mize and Farnham Corporation have not, directly or indirectly, engaged nor are they about to engage in acts and practices which have constituted or will constitute violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 promulgated thereunder or Sections 14(d) and (e) of the Securities Exchange Act of 1934 and Rule 14d-1 promulgated thereunder.

3. The Securities and Exchange Commission is entitled to none of the relief sought in its complaint on file herein.

4. The preliminary injunction heretofore entered against the defendants, D. Doyle Mize and Farnham Corporation on or about October 1, 1975 should be in all things dissolved.

5. All Findings of Fact which are more properly characterized as Conclusions of Law are hereby adopted as such. All Conclusions of Law which are more properly characterized as Findings of Fact are hereby adopted as such.

Signed at Houston, Texas, this 27th day of October, 1977.

/s/ ROBERT O'CONOR JR.
United States District Judge

APPENDIX "B"

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellant,

v.

D. DOYLE MIZE ET AL.,
Defendants-Appellees.

No. 78-1049.

United States Court of Appeals,
Fifth Circuit.

April 23, 1980.

Appeal from the United States District Court for the Southern District of Texas.

Before MORGAN, REAVLEY and HATCHETT, Circuit Judges.

LEWIS R. MORGAN, Circuit Judge:

The Securities and Exchange Commission brought this action to permanently enjoin D. Doyle Mize, Farnham Corporation, and others[1] from engaging in future violations of the antifraud and tender offer provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); Sections 10(b), 14(d), and 14(e) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and 78n(d), and 78n(e), and Rules 10b-5 and 14d-1 thereunder, 17 C.F.R. 240.10b-5 and 240.14d-

[1] The SEC's complaint named the following parties as defendants in the action: D. Doyle Mize; Southdown, Inc.; Valhi, Inc.; Farnham Corporation; Leland McCarthy; and Richard McCarthy. The McCarthys, Valhi, Inc. and Southdown, Inc. consented, without admitting or denying the allegations in the complaint, to the entry of permanent injuctions against further violations of the securities laws. Southdown, Inc. also consented to the establishment and maintenance of various procedures designed to prevent further securities laws violations.

1. After a hearing, the District Court for the Southern District of Texas entered a judgment for defendants denying injunctive relief. On appeal, the SEC contends that the court misinterpreted the evidence and applied an erroneous legal standard in assessing the materiality of certain facts in this case.

I.

D. Doyle Mize (Mize), the principal figure in this action, was chairman of the board of directors and chief executive officer of Southdown, Inc. (Southdown) and later of Valhi, Inc. (Valhi), a wholly-owned subsidiary of Southdown. The gravamen of the SEC's complaint is that Mize and certain of his business associates made repeated secret attempts to gain personal voting control of Valhi at prices below book value. To effectuate their scheme, defendants allegedly filed with the SEC and disseminated to the public various documents which contained both affirmative misstatements and material omissions of fact. The defendants respond that Mize made every effort to comply with the federal securities laws and engaged in no act or practice which in any way violated those laws.

BACKGROUND

Southdown is a publicly-held Louisiana corporation headquartered in Houston, Texas, whose stock is registered with the SEC and traded on the New York Stock Exchange. During the early 1970s, Southdown was engaged, through its subsidiaries, in the production and marketing of cement, sugar, malt beverages, soft drink beverages, table wines and other consumer products. The company was also engaged in oil and gas operations and had large scale agricultural land development and farming interests. The company's agricultural operations were conducted through its Valhi subsidiary.

In 1971 the Southdown board of directors determined that the company's agricultural subsidiary was financially incompatible with Southdown's other business endeavors and was actually

depressing the value of Southdown's stock. The directors reasoned that investors interested in the stable, current yield associated with Southdown's manufacturing operations were attributing little, if any, significance to the high risk — high profit features and long-term growth requirements of the company's farming business. For this reason, the board proposed to divide Southdown into separate agricultural and manufacturing entities having generally different operating characteristics and capital requirements. To assess the wisdom of this plan, Southdown consulted two investment advisers, each of whom endorsed the proposed separation.

In 1973 and 1974 the board of directors authorized two attempts to divide Southdown into separate entities. These efforts were abandoned, however, when, on one occasion, a number of shareholders instituted lawsuits seeking to enjoin the separation and, on another occasion, the company encountered certain mechanical difficulties in accomplishing the separation. The search for ways to divide the compnay continued, and, on March 27, 1975, the board of directors unanimously approved the spin-off of Valhi from the parent corporation and announced in a press release its filing of a registration statement and accompanying prospectus with the SEC. On May 13, 1975, the spin-off was consummated when Southdown distributed the stock of Valhi as a dividend to Southdown's common shareholders.

The alleged secret attempts by Mize to gain control of Valhi occurred during the period immediately prior to and following the May 1975 spin-off. These events can conveniently be discussed as the (1) the Lambert tender offer proposal, (2) the Peterson deal, and (3) the Farnham counter-tender offer.

The Lambert Tender Offer Proposal.

In November 1974 a New York representative of Lambert Freres et Cie., Inc. (Lambert), a French construction company, telephoned Mize in Houston, Texas. The representative

informed Mize that Lambert had observed Southdown's previous unsuccessful attempts to spin off its Valhi subsidiary and suggested that Lambert might be able to assist Southdown in achieving that goal. After further discussion, Mize learned that Lambert was considering making a tender offer for Southdown stock. Lambert stated that it was primarily interested in Southdown's cement operations and had little or no interest in the company's farming operations or in the other businesses in which Southdown was engaged. Lambert then made clear that if the acquisition were accomplished it would be interested in selling Valhi in order to help finance the tender offer for Southdown. Aware that Mize had long been interested in working exclusively with Southdown's agricultural subsidiary, Lambert suggested that Mize form an investment group with Leland McCarthy and Richard McCarthy for the purpose of purchasing Valhi.[2] Mize expressed interest in this proposal.

On January 23, 1975, Lambert forwarded to the Southdown board of directors a letter[3] proposing a tender offer for a majority of Southdown's common stock at a minimum price of $12 per share and its preferred stock at a minimum price of $25 per share. The letter stated that because Lambert had no interest in Valhi's agricultural operations it would, after gaining control of Southdown, distribute the Valhi stock on a pro rata basis to Southdown shareholders. The letter further stated that the tender offer proposal was "based on the understanding that Messrs. Mize, L. McCarthy and R. McCarthy would agree to purchase all shares of Valhi common stick to be owned by Lambert" at $10 per share.

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[2] Richard and Leland McCarthy were operating principals of Valhi and the owners of 17 percent of the company's stock. Southdown had previously announced that in the event of a separation of Valhi from Southdown, the McCarthys and Mize intended to work for Valhi.

[3] The Lambert letter was based on and virtually identical to a draft letter of intent which had been prepared by Southdown, under Mize's direction, and mailed to the Lambert representative.

On January 24, 1975, Southdown issued a press release notifying shareholders of the possibility of a cash tender offer for Southdown stock and stating that it intended to cooperate with the proposed offeror's efforts to conduct a financial review of the company. The press release emphasized the contingent nature of the tender offer, noting that the board of directors could give no assurances that the offeror would ultimately decide to proceed with its proposal or that the directors would be able to recommend the tender offer to shareholders. Unlike Lambert's January 23, 1975 letter, however, the press release made no mention of the proposed distribution of Valhi shares to Southdown shareholders or of the possible sale to Mize and the McCarthys of the Valhi shares Lambert would receive in the distribution.

The Peterson Deal.

During the early fall of 1974 and prior to the negotiations with Lambert, Charles Peterson, a former president of National Alfalfa Dehydrating & Milling Company (National Alfalfa),[4] expressed an interest in having Southdown or one of its subsidiaries purchase his 51 percent block of National Alfalfa stock. At that time Peterson's stock was pledged to secure a 4.5 million dollar loan which he had obtained from Crown Cork Financial. Peterson indicated that he wanted to sell his stock for an amount sufficient to repay his loan obligation and that he wanted an equity interest in the entity that ended up owning the National Alfalfa stock. Interested in this proposal, Southdown drafted a preliminary purchase agreement for Peterson's stock. In October 1974, however, negotiations were terminated because Southdown, in an unrelated transaction, was planning to file a registration statement with the SEC and lacked sufficient information about National Alfalfa to include in its registration materials. On several occasions during the winter of 1974-75

[4] National Alfalfa is a publicly-held company with assets consisting of irrigated corn land in Nebraska, Kansas, and Texas.

Mize reaffirmed Southdown's interest in National Alfalfa and indicated that future negotiations with Peterson might be possible.

On March 27, 1975, the day Southdown announced the spin-off of its agricultural subsidiary, Mize resigned as an officer and director of Southdown and became chairman of the board of directors and chief executive officer of Valhi. In early 1975 Mize prepared a memorandum entitled "Valhi/NA/CP" which outlined a proposal whereby Valhi would acquire 100 percent of the stock of National Alfalfa.[5] The memorandum provided that:

1. Valhi would issue preferred stock to Peterson in exchange for his National Alfalfa stock;

2. Peterson would contribute the Valhi preferred stock to Farnham Corporation (a newly-formed company) in exchange for (a) $7,000,000 which he would use to pay off his loan secured by the National Alfalfa stock and (b) a 24.5 percent ownership interest in Farnham Corporation;

3. Mize and the McCarthys would transfer to Farnham Corporation approximately $2,250,000 in assets in exchange for which Mize would receive 26.5 percent ownership interest in Farnham and each of the McCarthys would receive 24.5 percent;

4. Farnham Corporation would borrow the $7,000,000 to be paid by Peterson by pledging as collateral the Valhi preferred stock which it would obtain from Peterson.

On April 15, 1975, Mize delivered the Valhi/NA/CP memorandum to Peterson. Peterson was interested in the Mize proposal and, at one point, indicated that he was willing to

[5] The acquisition by Valhi of Peterson's 51 percent block of National Alfalfa stock was the first step in a plan to acquire all of the stock of National Alfalfa. Following the purchase of Peterson's stock, Valhi was scheduled to make a cash tender offer for the balance of the National Alfalfa stock owned by persons other than Peterson or, alternatively, to merge Valhi and National Alfalfa.

proceed with the deal if Mize could obtain necessary financing. However, because he was anxious to pay off the loan encumbering his National Alfalfa stock, Peterson stated that he would continue in his efforts to sell the stock to persons other than Valhi.

On April 25, 1975, Mize and the McCarthys met with representatives of a California bank to inquire whether the bank would be willing to lend Farnham Corporation, upon its incorporation, $7,000,000 to be used by Peterson to pay off his loan to Crown Cork Financial. On May 13, 1975, officers of the bank advised Mize that the bank would approve the loan provided all other aspects of the proposal set forth in the Valhi/NA/CP memorandum were accomplished.

Although the negotiations with Peterson occurred contemporaneously with Southdown's efforts to spin off its Valhi subsidiary, neither the prospectus mailed to Southdown shareholders on April 18, 1975 nor any of its amendments made any mention of the deal proposed in the Mize memorandum. In May 1975 a number of Southdown shareholders instituted lawsuits seeking to enjoin the Valhi spin-off, and on May 15, 1975, the district court entered a temporary restraining order prohibiting the distribution of the Valhi shares as a dividend by Southdown.[6] Faced with this development, Mize concluded that the deal set forth in the Valhi/NA/CP memorandum was no longer viable, and he abandoned the idea altogether.

The Farnham Counter-Tender Offer.

In July 1975 Contram Corporation, a Dallas-based investment company, made a tender offer for Valhi stock. After learning of this development, Mize, L. McCarthy, and R. McCarthy formed Farnham Corporation for the purpose of making a

[6] The temporary restraining order was dissolved on May 23, 1975, and on May 28, 1975, the Valhi stock was distributed to those persons who were Southdown shareholders as of the record date of the spin-off.

counter-tender offer for Valhi. In connection with this attempt, Farnham filed a Schedule 13D statement with the SEC and mailed tender offer materials to the Valhi shareholders. None of Farnham's offering materials informed shareholders that Mize and the McCarthys had made previous unsuccessful attempts to gain control of Valhi.

On July 29, 1975, Contram filed a lawsuit in federal district court seeking to enjoin the Farnham tender offer. The district court issued the injunction, and, as a consequence, Contram was successful in acquiring 51 percent of Valhi.

After hearing the evidence, the district court held that the SEC had not proved that defendants had violated the federal securities laws nor established that there was a reasonable likelihood that defendants were about to engage in violations of those laws. The court characterized the Lambert and Peterson negotiations as mere "ideas" in the formulative stage which never reached a degree of maturity so as to require disclosure to the SEC or the investing public. The SEC contends that the court's holding strikes at the concept of "full disclosure" which stands at the heart of the federal securities laws and overlooks entirely the affirmative misstatements of fact made by defendants. In addition, the SEC argues that the court applied an erroneous standard of materiality to the facts in this case.

II.

The SEC is authorized to seek injunctive relief whenever it appears that a person is engaged in or "about to engage in" acts or practices which constitute a violation of the federal securities laws. Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b); section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d). The district court is required to grant the requested injunction "upon a proper showing" by the SEC. *Id.* To satisfy the "proper showing" requirement in a case where current violations are not alleged, the SEC must establish that there is a reasonable likelihood that the defendant, if not

enjoined, will engage in future violations of the securities laws. *SEC v. Blatt*, 583 F.2d 1325, 1334 (5th Cir. 1978); *SEC v. Commonwealth Securities, Inc.*, 574 F.2d 90, 99-100 (2d Cir. 1978). The decision to grant or deny injunctive relief will be reversed on appeal only if the district court abused its discretion or failed to apply the proper legal standard.

Although the SEC contends that defendants made several misstatements of fact, most of the alleged deficiencies in this case relate to Mize's failure to disclose the negotiations he had engaged in with Lambert and Peterson, negotiations which the SEC contends were material facts under the federal securities laws. Materiality requires "a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976).

It is clear that some facts are deemed material even though they refer to a prospective and, therefore, contingent event "provided there appears to be a reasonable likelihood of its future occurrence." *Sonesta International Hotels Corp.* v. *Wellington Associates*, 483 F.2d 247 (2d Cir. 1973). In the landmark case of *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969), the Second Circuit formulated the standard of materiality to be applied in such cases:

> [M]aterial facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities.
>
> In each case, then, whether facts are material within Rule 10b-5 when the facts relate to a particular event and are undisclosed by those persons who are knowledgeable thereof will depend at any given time upon a *balancing of both the indicated probability that the event will occur and*

> *the anticipated magnitude of the event in light of the totality of the company activity.*

Id. at 849 (emphasis added). *See also Harkavy* v. *Apparel Industries, Inc.*, 571 F.2d 737, 741 (2d Cir. 1978); *SEC* v. *Shapiro*, 494 F.2d 1301, 1305-06 (2d Cir. 1974); *Sonesta International Hotels Corp.* v. *Wellington Associates, supra*, 483 F.2d at 251: *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 368 (2d Cir. 1973); *cert. denied*, 414 U.S. 910, 94 S.Ct. 231, 232, 38 L.Ed.2d 148 (1974).

III.

The SEC argues that the press release issued during the Lambert tender offer negotiations was false and misleading because it failed to disclose Lambert's intention to distribute Valhi to Southdown's shareholders and to sell the Valhi stock it acquired in the distribution to Mize and the McCarthys.

The January 24, 1975 press release was disseminated the day after the board of directors received the letter from Lambert setting forth the proposed tender offer for Southdown. The press release announced that a "foreign entity" was considering making a tender offer for Southdown and informed investors that the directors intended to cooperate in a financial review of the company. The release gave a brief description of the terms and conditions of the offer, including the projected per share prices referred to in the Lambert letter, but omitted the information contained in paragraphs five and six of that letter. These paragraphs stated in part:

> Fifth, we have concluded from a preliminary review of Southdown and its subsidiaries that the continued operation by Southdown of the agricultural and land development businesses presently being conducted by it through its wholly-owned subsidiary, [Valhi], would be inconsistent with the plans and policies which we would seek to adopt and implement following the tender offer. Accordingly, as promptly as practicable following a successful tender offer, it would be our intention to cause the management of Southdown to

> submit to the board of directors of Southdown . . . a proposal to distribute to the holders of Southdown common stock all 1,096,812 shares of common stock of Valhi.
>
> Sixth, Lambert is not interested in investing in agricultural and land development operations, and continuity of management is essential to disposal of these interests following the successful completion of the tender offer. Therefore, the approach set forth in this letter is based on the understanding that Messrs. Mize, L. McCarthy and R. McCarthy would agree to purchase all shares of Valhi common stock to be owned by Lambert following the stock distribution referred to in paragraph fifth above for $10 per share.

The district court found that the Lambert proposal was not "a plan but only an idea" and that the matters discussed in these paragraphs did not constitute material facts.

The SEC lists a number of reasons why the undisclosed information would have been important to the reasonable investor. First, the SEC points out that Lambert was interested in selling its Valhi stock in order to help finance the purchase of Southdown stock. It then argues that disclosure of Lambert's need for additional cash to finance a tender offer would have caused some investors to conclude that the tender offer would not succeed and, therefore, would have affected their investment decisions. Second, the SEC contends that disclosure of the information would have provided investors with an indication of Lambert's future intentions regarding a valuable subsidiary. Finally, the SEC argues that disclosure would have alerted investors to a possible conflict of interest arising from Mize's dual role as a negotiator for Southdown interested in the highest price for Southdown shares, and as a negotiator for himself interested in acquiring Lambert's Valhi shares at the lowest possible cost.

The defendants respond by characterizing the proposed Valhi spin-off and consequent sale of Lambert's Valhi shares to the Mize group as too speculative and "iffy" a proposition to be discussed in a press release. In one sense, the undisclosed information was no "iffier" than those aspects of the Lambert proposal which were included in the press release. The letter from Lambert suggested a tentative "approach" for accomplishing the proposed tender offer, and the press release emphasized that the Southdown board could give no assurances that "any cash tender offer ultimately would be made by such offeror or, if made, that the final terms and conditions of such offer would be satisfactory to Southdown and its security holders." Clearly, the conditional nature of the tender offer infected the whole proposal and not just the contents of paragraphs five and six. Conversely, paragraphs five and six contain no language suggesting that this aspect of the proposal was subject to certain special conditions which did not apply to the tender offer as a whole.[7] It is at least arguable, therefore, that the Valhi spin-off and the purchase by Mize of Lambert's Valhi shares were no less certain to occur than the other aspects of the tender offer proposal.

In another sense, however, the proposition set forth in paragraphs five and six of the Lambert letter was less likely to occur than the tender offer itself. Lambert's principal reason for proposing a tender offer was its interest in acquiring Southdown's cement operations. Aware that Southdown had been searching for a way to spin off its Valhi subsidiary, Lambert proposed a plan whereby it could acquire the desired cement interests and, in the process, Southdown could divide itself into separate entities. Obviously, the mutually beneficial

[7] The paragraphs state that *"it would be our intention* to cause the management of Southdown to submit to the board of directors" a proposal to spin off Valhi, and that "the approach set forth in this letter *is based on the understanding* that Messrs. Mize, L. McCarthy and R. McCarthy *would agree* to purchase all shares of Valhi to be owned by Lambert following the stock distribution." (emphasis added.)

aspects of this proposal were designed to make the tender offer attractive to Southdown and did not reflect a disinterested desire to help Southdown achieve its objective. Therefore, a decision by Southdown not to cooperate with Lambert's bid for control of the company would not necessarily have dissuaded Lambert, provided it secured adquate financing,[8] from tendering for Southdown stock. Furthermore, at the time the press release was issued the discussions with Lambert were in the negotiation stage and had not culminated in an agreement to proceed with the proposal outlined in the Lambert letter. It was entirely possible that, after further study, the Southdown board would find the tender offer proposal unacceptable and decide to resist Lambert's efforts to acquire Southdown.

The record indicates that Southdown issued the press release out of fear that someone from Lambert, a company over which Southdown had no control, would fail to maintain the confidentiality of the tender offer negotiations. In order to forestall the misuse of this material inside information, Southdown determined that it was "imperative . . . to make some public disclosure of the essence of what was being discussed." Once this decision was made, the Southdown board was presented with the more difficult task of selecting the information to be included in its press release. On advice of counsel, the board, with Mize abstaining, decided to state only that there was a remote possibility of a tender offer for Southdown stock. The district court agreed with the decision of Southdown's counsel that the likelihood of the occurrence of the proposition set forth in paragraphs five and six was not sufficiently appreciable to

[8] The evidence indicates that the funds Lambert would receive from the sale of the Valhi shares it received in the proposed stock distribution were needed to finance, at least in part, Lambert's tender offer for Southdown. However, nothing in the record indicates that the sale of its Valhi shares to Mize and the McCarthys was the only possible means of financing available to Lambert. Had Lambert secured funds from other sources, the need to sell its Valhi shares would never have arisen.

require disclosure of this information. We are unwilling to disturb this finding.

The Supreme Court has admonished reviewing courts that the determination of materiality "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him and these assessments are peculiarly ones for the trier of fact." *TSC Industries, Inc.* v. *Northway, Inc., supra,* 428 U.S. at 450, 96 S.Ct. at 2133. After reviewing all the facts and circumstances in this case, we hold that the district court did not err in concluding that the press release was not false and misleading because it failed to include the contents of paragraphs five and six of the Lambert letter. As this court has observed elsewhere, we do not imply that the undisclosed information was not of sufficient importance to support a finding of materiality. "Clearly it was. We hold only that the question of the materiality of the [information] was within the legitimate province of the jury." *Smallwood* v. *Pearl Brewing Co.,* 489 F.2d 579, 604-05 (5th Cir.), *cert. denied,* 419 U.S. 873, 95 S.Ct. 134, 42 L.Ed.2d 113 (1974).

According to the SEC, the Peterson deal involved the most egregious violations of the federal securities laws and best illustrates Mize's surreptitious attempts to gain control of Valhi. Essentially, the SEC argues that the registration statement and prospectus prepared in connection with Southdown's decision to spin off Valhi were materially false and misleading because (1) they *ommitted* any mention of the Valhi/NA/CP memorandum drafted by Mize and (2) they *affirmatively misstated* that there were no plans to issue preferred stock or to declare cash dividends, that earnings would be retained to finance expansion and development, and the reasons for the Valhi spin-off.

During the interim between March 27, 1975, when Southdown announced the Valhi spin-off and its filing of a registration statement and prospectus with the SEC, and May 13,

1975, the record date of the stock distribution to Southdown shareholders, Mize developed the proposal which he incorporated in the 27-page Valhi/NA/CP memorandum. This proposal, delivered to Peterson on April 15, 1975, involved a complex series of transactions which culminated in the creation of a new company owning 520,000 shares of newly-issued Valhi preferred stock. The stock of the new company, Farnham Corporation, was to be owned jointly by Mize, Peterson, and the McCarthys. The district court concluded that the Mize proposal involved mere "ideas" which had not reached a stage of maturity where disclosure was required.

Initially, it is clear that the "anticipated magnitude" element of the *Texas Gulf Sulphur* test, when applied to these facts, militates in favor of disclosure of the Peterson negotiations. The decision by Southdown to spin off Valhi was a major event in the life of both corporations. Shareholders and investors faced with this development would naturally be concerned about the capital and dividend structure of the spun-off corporation. Moreover, an agreement between certain corporate insiders and a third party to gain a controlling interest in Valhi would have been an important consideration to shareholders trying to decide whether to buy, sell, or hold Southdown securities. Because the significance of the event to the corporation is established, the critical questions with respect to the Peterson deal relates to the likelihood of "indicated probability" that the Mize proposal would be effectuated. After a careful consideration of the record and with due deference to the district court's finding, we believe the balance in this case tips in favor of materiality.

In assessing the probability of the completion of the Peterson deal, we think it highly significant that the two principal hurdles in the Mize proposal, i.e., convincing Peterson of the merits of the deal and obtaining the necessary bank financing, had been successfully surmounted proir to the record date of the Valhi spin-off. Shortly after he received a copy of the Valhi/NA/CP

memorandum on April 15, 1975, Peterson informed Mize that he believed that the suggested approach was acceptable and that he was prepared to go forward with the deal if Mize could secure the necessary financing. Mize immediately set out to accomplish this goal. Following initial negotiations between the Mize group and representatives of a Fresno, California Bank concerning the possibility of a $7,000,000 loan to Farnham Corporation, on May 6, 1975, the bank representatives prepared a written loan report which concluded with the statement, "Approval is highly recommended." On May 13, 1975, the president, the principal loan officer, and the chief administrative officer of the bank informed Mize that the bank would be willing to make the loan if the other aspects of the Valhi/NA/CP proposal were accomplished. Although these developments occured during the sensitive period following the dissemination of the prospectus describing the Valhi spin-off, Mize made no efforts to disclose the terms of the Valhi/NA/CP memorandum.

It is true, as the defendants point out, that other steps had to be taken before the Mize proposal could be finalized in an "agreement." However, a proposal need not be final or consummated in order to be relevant to shareholder decisionmaking. Where the occurrence of a proposed course of action has reached a stage of probability rather than mere possibility, the negotiations concerning the proposed action must be disclosed even though the future event is not absolutely certain to occur. In this case the uncompleted aspects of the Valhi/NA/CP proposal did not present a significant obstacle to the realization of the Peterson deal. As Mize testified at trial, the deal would have succeeded if the shareholder suits to enjoin the Valhi spin-off had not been filed:

Q As far as your particular Peterson deal would have gone through had it not been for the lawsuits in connection with the spinoff?

A We terminated the Peterson deal without ever going to the lawyers because of a TRO being issued in the litigation.

Q Well, answer the question, please.

MR. HALL: I believe he did.

MR. BRODSKY: I asked him a yes or no question. I didn't say what caused the deal to be cut off. I'll ask the question again.

Q (By Mr. Brodsky) It would have gone through again had it not been for the lawsuits in this connection?

A *I believe it would have gone through.*

Emphasis added.

In conclusion, we are convinced that during the period immediately prior to the scheduled Valhi spin-off, the proposal incorporated in the Valhi/NA/CP memorandum had a very good chance of succeeding. We therefore hold that the failure to disclose this information or to amend certain statements in the registration statement and prospectus made these documents false and misleading. We also hold that the tender offer materials prepared by Farnham Corporation in connection with its counter-tender offer for Valhi should have disclosed that Mize, the McCarthys, and Peterson had made a previous unsuccessful attempt to gain control of Valhi.

In reviewing the district court's decision in this case, we have carefully considered the SEC's argument that the court failed to apply the accepted standard of materiality. We see no evidence in the record to support this contention. The court determined that the negotiations Mize engaged in with Lambert and Peterson had not reached a stage of development or maturity so as to require disclosure. The basis for this finding was the implied assumption that the omitted information would not have been important in the deliberations of the reasonable shareholder. Thus, although we disagree with the district court's conclusions

regarding the Peterson deal, we do not believe the court applied an erroneous legal standard to the facts in this case.

IV.

The SEC brought this action to enjoin defendants from engaging in future violations of the federal securities laws. In order to obtain the requested injunctive relief, the SEC has the burden of showing that there exists a reasonable likelihood that violations will occur in the future. To prove this likelihood, "[t]he Commission needs to go beyond the mere fact of past violations." *SEC v. Blatt*, 583 F.2d 1325, 1334 (5th Cir. 1978). Although we have found that the defendants did engage in past violations of the federal securities laws, we have not considered the question of whether these defendants are likely to engage in *future* violations. For this reason, we remand this case to the district court for further consideration. On remand, the district court should reconsider its finding of no reasonable likelihood of future violations in the light of our determination that past violations did occur.

REVERSED IN PART and REMANDED.

APPENDIX "C"
SECURITIES ACT OF 1933

SEC. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

* * *

SEC. 20. (b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the United States District Court for the District of Columbia to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this title. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received.

(c) Upon application of the Commission the district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia, shall also have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this title or any order of the Commission made in pursuance thereof.

* * *

SEC. 22. (a) The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No case arising under this title and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

* * *

Securities Exchange Act of 1934

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * *

SECTION 14(d)(1) It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any class of any equity security which is registered pursuant to section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 per centum of such class, unless at the time copies of the offer or request or invitation are first published or sent or given to security holders such person has filed with the Commission a statement containing such of the information specified in section 13(d) of this title, and such additional information as the Commission may by rules and

regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. All requests or invitations for tenders or advertisements making a tender offer or requesting or inviting tenders of such a security shall be filed as a part of such statement and shall contain such of the information contained in such statement as the Commission may by rules and regulations prescribe. Copies of any additional material soliciting or requesting such tender offers subsequent to the initial solicitation or request shall contain such information as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors, and shall be filed with the Commission not later than the time copies of such material are first published or sent or given to security holders. Copies of all statements, in the form in which such material is furnished to security holders and the Commission, shall be sent to the issuer not later than the date such material is first published or sent or given to any security holders.

(2) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for purposes of this subsection.

(3) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

(4) Any solicitation or recommendation to the holders of such a security to accept or reject a tender offer or request or invitation for tenders shall be made in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(5) Securities deposited pursuant to a tender offer or request or invitation for tenders may be withdrawn by or on behalf of the depositor at any time until the expiration of seven days after the time definitive copies of the offer or request or invitation are first published or sent or given to security holders, and at any time after sixty days from the date of the original tender offer or request or invitation, except as the Commission may otherwise prescribe by rules, regulations, or order as necessary or appropriate in the public interest or for the protection of investors.

(6) Where any person makes a tender offer, or request or invitation for tenders, for less than all the outstanding equity securities of a class, and where a greater number of securities is deposited pursuant thereto within ten days after copies of the offer or request or invitation are first published or sent or given to security holders than such person is bound or willing to take up and pay for, the securities taken up shall be taken up as nearly as may be pro rata, disregarding fractions, according to the number of securities deposited by each depositor. The provisions of this subsection shall also apply to securities deposited within ten days after notice of an increase in the consideration offered to security holders, as described in paragraph (7), is first published or sent or given to security holders.

(7) Where any person varies the terms of a tender offer or request or invitation for tenders before the expiration thereof by increasing the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder whose securities are taken up and paid for pursuant to the tender offer or request or invitation for tenders whether or not such securities have been taken up by such person before the variation of the tender offer or request or invitation.

(8) The provisions of this subsection shall not apply to any offer for, or request or invitation for tenders of, any security —

(A) if the acquisition of such security, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, would not exceed 2 per centum of that class;

(B) by the issuer of such security; or

(C) which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

(e) It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

* * *

SECTION 21. (d) Wherever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this title, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper

district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this title or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title.

(e) Upon application of the Commission the district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this title, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, (2) any national securities exchange or registered securities association to enforce compliance by its members and persons associated with its members with the provisions of this title, the rules, regulations, and orders thereunder, and the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.

* * *

SECTION 27. The district courts of the United States, the United States District Court for the District of Columbia, and

the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 18, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

* * *

SEC RULES

Rule 10b-5. (17 C.F.R. § 240.10b-5) Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

* * *

Rule 14d-1 (17 C.F.R. § 240.14d-1) Filing Schedule 14D-1 and furnishing of information to security holders.

(a) No person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, shall make a tender offer for, or a request or invitation for tenders of, any class of any equity security which is registered pursuant to section 12 of the Act, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of the Act, or any equity security issued by the closed-end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 percentum of such Class, unless, at the time copies of the offer or request or invitation are first published or sent or given to security holders, such person has filed with the Commission a statement containing the information and exhibits required by Schedule 14D-1.

(b) If any material change occurs in the facts set forth in the statement required by paragraph (a) of this section, the person who filed such statement shall promptly file with the Commission an amendment disclosing such change.

(c) All tender offers for, or requests or invitations for tenders of, securities published or sent or given to the holders of such securities shall include the following information:

(1) The name of the person making the tender offer, request or invitation;

(2) The exact dates prior to which, and after which, security holders who deposit their securities will have the right to withdraw their securities pursuant to section 14(d)(5) of the Act, or otherwise;

(3) If the tender offer or request or invitation for tenders is for less than all of the outstanding securities of the class and the person making the offer, request or invitation is not obligated to purchase all of the securities tendered, the date of expiration of the period during which the securities will be taken up pro rata pursuant to section 14(d)(6) [of the Act], or otherwise; and

(4) The information required by Items 1(c), 2(b), 2(e), 2(f) and 2(g); 3, 4, 5, 6, 7, 8, 9 and 10 of Schedule 14D-1 (§240.14d-100), or a fair and adequate summary thereof.

Instructions. 1. Negative responses to any such item or sub-item of Schedule 14d-1 (§240.14d-100) need not be included in the information published or sent or given to security holders.

2. Although the financial statements necessary to present a fair and adequate summary of Item 9 of Schedule 14D-1 §240.14d-100) may vary depending on the facts and circumstances involved, summary financial information equivalent to that required by paragraph e of Guide 59 of the Guides of Preparation and Filing of Registration Statements will normally be sufficient summary disclosure of Item 9 for purposes of paragraph (c)(4) of this section. If the information required by Item 9 is summarized, appropriate instructions should be included stating how more complete financial information can be obtained.

(d) Any additional material soliciting or requesting such tender offers subsequent to the initial solicitation or request shall contain the name of the persons making such solicitation or request and the information required by Items 1(c), 2(b), 2(e), 2(f) and 2(g); 3, 4, 5, 6, 7, 8, 9 and 10 of Schedule 14D-1

(§240.14d-100), or a fair and adequate summary thereof: *Provided, however,* That such material may omit any of such information previously furnished to the persons solicited or requested for tender offers. Copies of such additional material soliciting or requesting such tender offers shall be filed with the Commission not later than the time copies of such material are first published or sent or given to security holders.

(e) Ten copies of the statement required by paragraph (a), every amendment to such statement, and all other material required by this rule and such statement shall be filed with the Commission.

(f) If any securities to be offered in connection with the tender offer for, or request or invitation for tenders of, securities with respect to which a statement is required to be filed pursuant to paragraph (a) of this section have been or are to be registered under the Securities Act of 1933, a copy of the prospectus containing the information required to be included therein by §230.434b of this chapter shall be filed as an exhibit to the statement required by paragraph (a) of this section. Any information contained in such prospectus may be incorporated by reference in such statement.

(g) The definition of beneficial owner set forth in Rule 13d-3 (§240.13d-3) for purposes of section 13(d)(1) of the Act shall apply also for purposes of section 14(d)(1) of the Act.

* * *

FEDERAL RULES OF CIVIL PROCEDURE

Rule 52.
Findings By the Court

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the

findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

* * *

Supreme Court, U. S.
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No. 80-212

In the Supreme Court of the United States

OCTOBER TERM, 1979

D. DOYLE MIZE AND FARNHAM CORPORATION,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals erred in remanding for further consideration the district court's denial of injunctive relief after holding that the district court granted a dismissal motion under Fed. R. Civ. P. 41(b) based on the erroneous conclusion that the evidence submitted by the Commission did not establish a violation of law.

2. Whether the court of appeals erred in reversing the district court's holding that an undeniably significant proposed corporate event need not be disclosed as a material fact under the federal securities laws because it was not a "final plan," even though the proposed event was very likely to occur.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B) is reported at 615 F. 2d 1046. The judgment, findings of fact and conclusions of law of the district court (Pet. App. A) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on April 23, 1980. A petition for rehearing was denied on May 21, 1980. The petition for a writ of certiorari was filed on August 13, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES, REGULATIONS AND RULE INVOLVED

The pertinent statutory provisions and regulations are set forth in Appendix C to the petition. Fed. R. Civ. P. 41(b) appears in the Appendix to this brief.

STATEMENT

The Securities and Exchange Commission ("Commission") instituted this action against D. Doyle Mize, Farnham Corporation and others[1] in the United States District Court for the Southern District of Texas alleging

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[1]The complaint named the following parties as defendants in this action: D. Doyle Mize, Southdown, Inc., Valhi, Inc., Farnham Corporation, Leland McCarthy and Richard McCarthy. The McCarthys, Valhi, Inc., and Southdown, Inc., consented, without admitting or denying the allegations in the complaint, to the entry of permanent injunctions against further violations of the securities laws. Southdown, Inc., also consented to the establishment and maintenance of various procedures designed to prevent future securities laws violations (Pet. App. B-1).

violations of antifraud[2] and tender offer[3] provisions of the federal securities laws. The Commission sought to enjoin each of the defendants from further violations of these provisions (Pet. App. B-1). The substance of the Commission's complaint was that petitioner Mize, who was chairman of the board of directors and chief executive officer of Southdown, Inc. ("Southdown"), and later of Valhi, Inc. ("Valhi"), a wholly owned subsidiary of Southdown, and certain of his business associates made repeated undisclosed attempts to gain personal voting control of Valhi at prices below book value (Pet. App. B-2). In order to effectuate this scheme the defendants filed with the Commission and disseminated to the public various documents that contained affirmative misstatements and omitted material facts needed to avoid deception. *Ibid.*

1. During the early 1970's, Southdown, a publicly-held Louisiana corporation, was engaged through its subsidiaries in a wide range of business activities, including cement manufacturing and agricultural operations (Pet. App. B-2). The agricultural operations were conducted through its Valhi subsidiary. *Ibid.* In 1971, the Southdown board of directors determined that Valhi was financially incompatible with its other business endeavors and proposed to divide Southdown into separate agricultural and manufacturing entities having different operating characteristics and capital requirements (Pet. App. B-2 to B-3). After several unsuccessful attempts to accomplish

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[2]Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5.

[3]Sections 14(d) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(d) and 78n(e), and Rule 14d-1 thereunder, 17 C.F.R. 240.14d-1.

this goal, the Southdown board unanimously approved a "spin-off" of Valhi from Southdown by a pro-rata distribution of Valhi's common stock to Southdown's shareholders as a dividend. Southdown issued a press release announcing the Board's action and the filing of the required registration statement and accompanying prospectus with the Commission (Pet. App. B-3). On May 13, 1975, the spin-off was consummated by the distribution of Valhi stock as a dividend to Southdown common shareholders. Without making any disclosure of his activities, petitioner Mize attempted to gain control of Valhi during the period immediately prior to and following the May 1975 spin-off.

2. During the early fall of 1974, Charles Peterson, a former president of National Alfalfa Dehydrating & Milling Company ("National Alfalfa"), expressed interest in having Southdown or one of its subsidiaries purchase his 51% block of National Alfalfa stock which, at that time, was pledged to secure a $4.5 million loan (Pet. App. B-5). Peterson sought to sell his stock for an amount sufficient to repay his loan obligation and to obtain an equity interest in the entity that purchased his stock. *Ibid.* Southdown expressed interest in this proposal and drafted a preliminary purchase agreement for the stock but, in October 1974, negotiations broke down because of disclosure requirements that could not be met. *Ibid.* On several occasions during the winter of 1974-1975, however, petitioner Mize reaffirmed Southdown's interest in National Alfalfa and indicated that future negotiations with Peterson might be possible (Pet. App. B-5 to B-6).

On March 27, 1975, the day that the Southdown board approved and announced the Valhi spin-off, petitioner Mize resigned as an officer and director of Southdown and became chairman of the board of directors and chief

executive officer of Valhi (Pet. App. B-6). In April 1975, petitioner Mize prepared a 27-page memorandum entitled "Valhi/NA/CP" that detailed a proposal involving a series of transactions whereby Valhi would acquire Peterson's stock in National Alfalfa and Mize and his associates would acquire control of Valhi. The proposal provided that (*ibid.*):

1. Valhi would issue all of the shares of a new class of preferred convertible voting stock to Peterson in exchange for his National Alfalfa stock;

2. Peterson would deliver the Valhi preferred convertible voting stock to Farnham Corporation (a newly formed corporation) in exchange for (a) $7 million which he would use to pay off his loan secured by the National Alfalfa stock and (b) a 24.5% ownership interest in Farnham Corporation;

3. Mize and two of his associates, who were the operating principals of Valhi, would transfer to Farnham Corporation approximately $2.25 million in assets in exchange for which Mize would receive 26.5% ownership interest in Farnham and each of his associates would receive 24.5%;

4. Farnham Corporation would borrow the $7 million to be paid to Peterson by pledging as collateral the Valhi preferred stock which it would obtain from Peterson; and

5. Valhi would declare dividends on its preferred stock and Farnham would use these monies to repay the $7 million loan.

Thus, at the conclusion of this series of events, petitioner Mize and his associates would own 75.5% of Farnham

Corporation, which in turn would own all of the shares of Valhi's preferred convertible voting stock (constituting voting control of Valhi), and Valhi would have voting control of National Alfalfa.[4]

Petitioner Mize personally delivered the "Valhi/NA/CP" proposal to Peterson on April 15, 1975. Peterson expressed his willingness to proceed with the deal if Mize could obtain the necessary financing. However, because he was anxious to pay off the loan encumbering his National Alfalfa stock, Peterson indicated that he would not cease in his efforts to find a buyer for his stock other than Valhi (Pet. App. B-6 to B-7).

Petitioner Mize immediately set out to obtain the necessary financing. On April 25, 1975, he and his associates met with representatives of a California bank, presented the proposal and inquired whether the bank would lend Farnham Corporation the $7 million to be exchanged with Peterson for the Valhi stock. On May 6, 1975, the bank representatives prepared a written loan report concluding that "[a]pproval is highly recommended." On May 13, 1975, senior officers at the bank's headquarters advised Mize that the bank would approve the loan, provided that the other portions of the proposal set forth in the Valhi/NA/CP memorandum were completed (Pet. App. B-7, B-16).

Although these negotiations concerning the Peterson proposal occurred contemporaneously with the considera-

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[4]The acquisition by Valhi of Peterson's 51% block of National Alfalfa stock was the first step in a plan to acquire all the stock of National Alfalfa. Following the purchase of Peterson's stock, Valhi was scheduled to make a cash tender offer for the balance of the National Alfalfa stock owned by persons other than Peterson or, alternatively, to merge Valhi and National Alfalfa (Pet. App. B-6).

tion by Southdown's directors of the spin-off of Valhi, neither the registration statement filed with the Commission nor the prospectuses mailed to Southdown's shareholders made any mention of the transaction.[5] Those documents stated affirmatively that no plans had been formulated for the issuance of Valhi preferred stock or the payment of dividends by Valhi to its shareholders.

In May 1975, a number of Southdown shareholders instituted lawsuits seeking to enjoin the Valhi spin-off for reasons unrelated to the Peterson transaction. On May 15, 1975, a temporary restraining order was entered in those suits prohibiting the distribution of the Valhi shares as a dividend by Southdown. After the restraining order was entered, however, petitioner Mize concluded that the proposal set forth in the Valhi/NA/CP memorandum was no longer viable, and he abandoned the plan altogether. The temporary restraining order subsequently was dissolved, and the Valhi spin-off was consummated on May 28, 1975 (Pet. App. B-7).

As petitioner Mize testified at trial, the Peterson proposal would have been consummated but for the shareholder suits (Pet. App. B-16 to B-17; emphasis omitted):

> Q. As far as your particular Peterson deal would have gone through had it not been for the lawsuits in connection with the spinoff?
>
> * * * * *
>
> A. I believe it would have gone through.

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[5]Although the prospectus was supplemented on May 13, 16, and 24, 1975, none of those supplements contained any reference to the Peterson deal (Ex. 107-109). "Ex." refers to the volume of Exhibits filed in the court of appeals.

3. In July 1975, Contram Corporation made a tender offer for the newly spun-off outstanding shares of Valhi. Upon learning of this development, petitioner Mize and his associates formed Farnham Corporation for the purpose of making a counter-tender offer for the Valhi stock. In connection with this attempt, Farnham Corporation, pursuant to the Securities Exchange Act,[6] filed a Schedule 13D statement with the Commission and distributed tender offer materials to the Valhi shareholders. None of these offering materials disclosed petitioner Mize's previous unsuccessful attempts to gain control of Valhi (Pet. App. B-7 to B-8).[7]

4. After the Commission presented the foregoing evidence in its case-in-chief, petitioner Mize and Farnham Corporation moved for a judgment of dismissal on the merits. The district court granted the motion, holding that the Commission had not proved that the defendants violated the securities laws or that there was a reasonable likelihood that the defendants were about to engage in violations of those laws (Pet. App. A-3, A-5). The district court characterized Mize's attempt to gain control of Valhi as mere "ideas" in the formative stage as opposed to a "final plan," concluding that it had never reached a sufficient degree of maturity to be a material fact and thus to require disclosure (Pet. App. A-5).

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[6]Section 13(d) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(d).

[7]On July 29, 1975, Contram Corporation filed a lawsuit in federal district court seeking to enjoin the Farnham Corporation counter tender offer. The district court issued an injunction and Contram ultimately was successful in acquiring 51% of the Valhi stock (Pet. App. B-8).

The court of appeals reversed in part the district court's grant of judgment in favor of petitioners. Although it agreed with the district court that the Peterson proposal was not consummated, and accepted the standard of law applied by the district court as enunciated in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), the court of appeals held that the district court erred in concluding that the Peterson proposal would not be important to a reasonable shareholder of Southdown considering the Valhi spin-off. In so concluding, the court of appeals balanced the probability that the proposal would be consummated and the anticipated magnitude of the event in light of the totality of the company's activity (Pet. App. B-15 to B-17). It held that the failure to disclose the proposal or to amend certain statements in the registration statement and prospectus made those documents false and misleading (Pet. App. B-17). The court also held that the tender offer materials of Farnham Corporation used in connection with its counter-tender offer for Valhi should have disclosed the previous unsuccessful attempt by petitioner Mize to gain control of Valhi. *Ibid.* The court of appeals remanded the case to the district court for further consideration. It also directed the district court to reconsider the question whether the defendants are likely to engage in future violations of the securities laws in light of its determination that past violations did occur (Pet. App. B-18).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court. Further review by this Court is therefore unwarranted.

1. Petitioners argue (Pet. 7-10) that the decision of the court of appeals, which reversed the judgment of the

district court and held on the record before it that a violation of the federal securities laws was established, deprived them of due process of law because they have not yet had an opportunity to present any evidence in defense. This contention is premature. The Commission does not dispute petitioners' right to introduce any relevant evidence on remand before the district court, nor does the decision of the Fifth Circuit preclude them from doing so. Rule 41(b) of the Federal Rules of Civil Procedure and the decisions of this Court and the Fifth Circuit confirm that, on remand after reversal of a judgment granting involuntary dismissal on the merits, defendants are not barred from presenting relevant evidence.[8] See, *e.g.*, *United States* v. *United States Gypsum Co.*, 340 U.S. 76, 85 (1950); *Riegel Fiber Corp.* v. *Anderson Gin Co.*, 512 F. 2d 784, 793 (5th Cir. 1975). In such situations, the district court should proceed with the case exactly as though the defendant's motion for dismissal had been denied. *Ingraham* v. *Wright*, 498 F. 2d 248, 265 (5th Cir. 1974), affirmed on other grounds, 430 U.S. 651 (1977).

This principle is illustrated by *United States* v. *United States Gypsum Co.*, 333 U.S. 364 (1948), in which this Court reversed a dismissal under Fed. R. Civ. P. 41(b) of an action brought to restrain a violation of the Sherman Act, holding that the record before it established a clear violation of the Act and remanding the case for further

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[8]While the district court should not compel the plaintiff to present its case a second time (*United States* v. *United States Gypsum Co.*, 333 U.S. 364, 402 n.20 (1948)), the plaintiff should be allowed to supplement its evidence either in a retrial of its case-in-chief or in rebuttal. See *Riegel Fiber Corp.* v. *Anderson Gin Co.*, 512 F. 2d 784, 793 (5th Cir. 1975); *Ingraham* v. *Wright*, 498 F. 2d 248, 265 (5th Cir. 1974), affirmed on other grounds, 430 U.S. 651 (1977); *White* v. *Rimrock Tidelands, Inc.*, 414 F. 2d 1336, 1340 & n.7 (5th Cir. 1969).

proceedings. 333 U.S. at 401-402. On remand, the defendants were free to introduce any evidence from which they might be found not to have violated the Act. See *United States* v. *United States Gypsum Co.*, *supra*, 340 U.S. at 85. In the present case, the petitioners likewise are not precluded from introducing evidence on remand concerning the materiality of the Peterson transaction. Accordingly, petitioners' claim that their right to due process has been violated is premature and not ripe for review.[9]

2. Petitioners further argue (Pet. 11-13) that the decision of the court of appeals conflicts with *Aaron* v. *SEC*, No. 79-66 (June 2, 1980), because they have not had an opportunity to show lack of scienter. However, under the principles summarized above, they are free to present such evidence on remand. In any event, petitioners did not raise the issue of scienter on appeal, nor did the court of appeals consider it. Thus, petitioners should not be heard to raise that issue for the first time in this Court.

3. The court of appeals held that, although the district court selected the appropriate legal standard for determining materiality and the district court's findings of fact were not clearly erroneous, the district court erred in concluding that the Peterson proposal was not material. In so holding, the court of appeals adhered to established principles governing appellate review of questions of

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[9]Petitioners also argue (Pet. 9) that they may be collaterally estopped from litigating the issue of past violations of the federal securities laws in private lawsuits. However, petitioners have not been denied an opportunity to contest that issue, either in this proceeding or in any private suit. Should the district court make a finding adverse to petitioners on remand, and should it later be alleged in a private lawsuit that they are collaterally estopped from contesting that finding, the district court in the private lawsuit will have broad discretion to determine whether the doctrine of collateral estoppel should be applied. *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 331 (1979).

materiality, which may be resolved "as a matter of law" when, as here, reasonable minds cannot differ as to the importance of the omitted facts. *TSC Industries, Inc.* v. *Northway, Inc., supra,* 426 U.S. at 450.[10]

While it is true that, in reviewing a determination of materiality, findings of basic fact must be sustained unless clearly erroneous, an appellate court is obligated to consider for itself the legal import of basic facts found by the district court. See Pet. App. B-14; *SEC* v. *Bausch & Lomb Inc.*, 565 F. 2d 8, 15 (2d Cir. 1977); *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 849 n.11 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). In the present case, contrary to petitioners' contentions (Pet. 13, 15), the court of appeals did not disagree with any of the basic facts found by the district court. Indeed, the court of appeals expressly agreed with the findings of the district court that the Peterson deal was not a final plan (Pet. App. B-16). The court of appeals rejected, however, the legal conclusion of the district court that because the Peterson proposal was not final it could not be material; the court of appeals correctly recognized that "a proposal need not

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[10]Petitioners' argument (Pet. 11 n.11) that the undisclosed information concerning the Peterson proposal was not material completely misses the point. Petitioners argue that by May 28, 1975, the first date on which a Southdown shareholder would have received Valhi stock under the spin-off, a reasonable investor would have attached little, if any, significance to the irrevocably abandoned Peterson proposal in making an investment decision concerning *Valhi* stock. But the court of appeals correctly recognized that the proper focus in determining the materiality of the Peterson proposal, before it had been abandoned, was its significance to a reasonable investor in making an investment decision concerning whether to purchase or sell *Southdown* stock. Southdown shareholders had to decide whether to buy, sell, or hold their Southdown shares prior to May 13, 1975, the record date on which the rights of Southdown shareholders to the Valhi stock would be determined. On that date, the Peterson transaction had not been abandoned.

be final or consummated in order to be relevant to shareholder decisionmaking." *Ibid.* See, *e.g.*, *SEC* v. *Texas Gulf Sulphur Co.*, *supra*, 401 F. 2d at 849; *SEC* v. *Shapiro*, 494 F. 2d 1301, 1306-1307 (2d Cir. 1974); *Rochez Bros., Inc.* v. *Rhoades*, 491 F. 2d 402, 408 (3d Cir. 1974). The court properly held that the materiality of an inchoate transaction depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." See Pet. App. B-9 to B-10 (emphasis omitted), quoting *SEC* v. *Texas Gulf Sulphur Co.*, *supra*, 401 F. 2d at 849. See also *Harkavy* v. *Apparel Industries, Inc.*, 571 F. 2d 737, 741 (2d Cir. 1978); *SEC* v. *Shapiro*, *supra*, 494 F. 2d at 1305-1306.

The court of appeals correctly concluded on the record before it that the likelihood that the Peterson transaction would be effectuated was so substantial and was of such significance to shareholders trying to decide whether to buy, sell or hold Southdown's securities that its disclosure was essential. That proposal, whereby Valhi would have acquired a controlling interest in National Alfalfa and would have issued a controlling block of preferred stock to petitioner Mize and his associates, was a major event in the life of the corporation. Moreover, the two principal hurdles to the proposal, obtaining Peterson's approval and the necessary bank financing, had been surmounted by the date of the spin-off and by the time the prospectuses were in use. Indeed, even petitioner Mize admitted that the proposal would have been consummated but for shareholder lawsuits. Thus, the balancing engaged in by the court of appeals was not, as petitioners suggest (Pet. 10-11, 15-16), a *de novo* review of the findings of basic fact, but rather was the determination of an ultimate issue, *i.e.*, materiality, by applying the appropriate legal standard. The court of appeals

specifically recognized the weight to be accorded findings of fact by the district court and paid "due deference to the district court's finding" on the Peterson transaction (Pet. App. B-15). On the record before it, however, the court correctly determined that the legal balance tipped in favor of materiality and disclosure.[11]

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1980

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[11]Petitioners also argue (Pet. 13) that the court of appeals erred in reversing the district court's denial of injunctive relief without any express finding that the district court abused its discretion. However, misapplication of the law is itself an abuse of discretion requiring reversal. See *e.g.*, *United States* v. *School District of Ferndale*, 577 F. 2d 1339, 1351 (6th Cir. 1978); *Milsen Co.* v. *Southland Corp.*, 454 F. 2d 363, 369 (7th Cir. 1971). See also *Union Tool Co.* v. *Wilson*, 259 U.S. 107, 112 (1922).

DOJ-1980-09

APPENDIX

FEDERAL RULES OF CIVIL PROCEDURE

RULE 41

DISMISSAL OF ACTIONS

* * * * *

(b) *Involuntary Dismissal: Effect thereof.* * * * After the plaintiff, in an action tried by the court without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment until the close of all the evidence. If the court renders judgment on the merits against the plaintiff, the court shall make findings as provided in Rule 52(a). Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction, for improper venue, or for failure to join a party under Rule 19, operates as an adjudication upon the merits.

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PETITIONER'S REPLY TO SECURITIES AND EXCHANGE COMMISSION'S BRIEF IN OPPOSITION

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OPINIONS BELOW, JURISDICTIONAL STATEMENT, STATUTES AND RULES INVOLVED, AND STATEMENT OF THE CASE ARE SET OUT IN FULL IN PETITIONERS' PETITION TO THIS COURT.

ARGUMENT

Within the constraints imposed by Supreme Court Rule 22.5, this Reply Brief will address, in abbreviated form, the contentions raised in the Brief for the Securities and Exchange Commission in Opposition (hereinafter "Br.").

1. The Fifth Circuit decision of which review is sought explicitly limited the scope of the remand of this case to the trial court:

> *Although we have found that the defendants did engage in past violations of the federal securities laws* [emphasis added], we have not considered the question of whether these defendants are likely to engage in *future* [emphasis in original] violations. For this reason, we remand the case to the district court for further consideration. On remand, the district court should reconsider its finding of no reasonable likelihood of future violations *in the light of our determination that past violations did occur.* [emphasis added] Petitioners' Appendix (hereinafter "Pet. App.") B-18.

The Fifth Circuit has thus painstakingly instructed the trial court that the remand is to be limited to the issue of the likelihood of future violations and that in hearing the evidence on that issue, the trial court is to accept as a fact that the question of past violations has already been conclusively adjudicated. The quoted language demonstrates clearly that the Court of Appeals found — from the SEC's evidence alone — that a violation of the securities laws had been proven conclusively. The Solicitor General (in a thinly veiled confession of error) argues that Petitioners will be permitted to introduce evidence on the issue of past violation of the securities laws in the event of a remand. Br. 8-10. However, the trial court may feel compelled to heed the clearly expressed instructions of the Court of Appeals and receive evidence only on the issue of the "reasonable likelihood of future violations" of the securities laws. It is this result, so clearly intended by the panel of the Fifth Circuit, which Petitioners submit to be violative of their constitutional rights to due process, and a confession of error by the Solicitor General is no guarantee that such a result will not obtain. Only a decision of

this Court reversing or vacating the judgment of the Court of Appeals will insure that Petitioners will be permitted, if the case is remanded rather than reversed and rendered, to present their evidence to the trial court on all issues. It is the Fifth Circuit's opinion, not the SEC's apparent confession of error,[1] which Petitioners seek to have reviewed by this Court.

Petitioners' concern that the SEC's confession of error does not assure them that upon remand to the trial court the Petitioners will be given the right to re-open the issue of past violations is not mere premature speculation. On September 29, 1980, Mr. Robert A. Hall, one of Petitioners' attorneys of record, contacted Mr. Douglas J. Scheidt, one of Respondent's attorneys of record. Mr. Hall asked Mr. Scheidt if the SEC would agree to submit to this Honorable Court, at this time, a joint motion and an agreed order remanding this case to the Court of Appeals for reconsideration of the Court of Appeals' instructions to the trial court concerning what issues could be considered on remand. Petitioners are of the view that such a procedure would enhance the likelihood of their being allowed to offer their evidence relative to past violations. Mr. Scheidt advised Mr. Hall that the SEC would *not* agree to join in such a motion and order. Thus, not only are the private litigants in the pending related case not bound by the SEC's confession of error, but even the SEC itself apparently does not intend to be so bound upon any remand of this case.

2. Petitioners had no reason to complain earlier in the proceedings in this case, as they have complained to this Court

[1] The SEC also gainsays Petitioners' concerns about the possible collateral estoppel ramifications of the panel's adjudication of past securities violations. Br. 10, n. 9. Petitioners submit that the plaintiff in the pending private lawsuit against petitioners will not be bound by the Solicitor General's confession of error on this Petition. Presumably, the plaintiffs in the private action, buttressed by *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322 (1979), will attempt to assert the collateral estoppel effect of the Court of Appeals' decision in this case, if left unreviewed by this Court. The district court judge to whom the private lawsuit has been assigned is not the same district court judge who will hear this case upon remand.

in their Petition for Certiorari, of the lack of a finding or suggestion by any court below of scienter on their part. Prior to the unusual disposition of this case by the Court of Appeals, the scienter issue had not become relevant in the manner in which it now is.[2] When this case was appealed by the SEC to the Court of Appeals, both parties were of the view that the substantive issue being litigated on the appeal was the materiality of the allegedly undisclosed information. The parties thought that the district court judgment would stand or fall on that basis, with the Fifth Circuit either affirming the trial court judgment or remanding the entire case for a new trial.[3] However, the Fifth Circuit panel not only made a determination on the question of materiality, but also, acting *sua sponte*, made a quantum leap from that determination to the determination that past securities violations had been established. In finding securities violations, the Court

[2] As made clear by this Court's decision in *Aaron* v. *SEC*, — U.S. —, 100 U.S. 1945 (1980), scienter is an essential element of proof for the SEC to establish a violation of the antifraud securities statutes upon which this action is based. Yet, it is clear from the district court's Findings of Fact and Conclusions of Law — especially Findings 10, 15, 16 and 18 — that in passing judgment on the SEC's proof, the district court found a lack of scienter. Implicit in the trial court's conclusion that Petitioners' actions had not violated the securities laws is the recognition of a lack of any fraudulent, deceptive or manipulative intent in Petitioners' conduct. Had the SEC proven a prima facie case at trial, defendants-Petitioners were prepared to produce the testimony of some seventeen witnesses, much of whose testimony would have been to the effect of a lack of scienter.

Though finding violations of the securities laws, the opinion of the appellate panel below nowhere finds or suggests scienter on the part of Petitioners. Rather, in the panel's analysis, nondisclosure of information found to be material, with no inquiry whatsoever into Defendant's state of mind or intent, constitutes an automatic violation of the securities antifraud statutes. This analysis was flatly repudiated by this Court in its decision in *Aaron, supra*.

[3] In their briefs in the Court of Appeals, the relief sought by the SEC was a remand of the entire case to the district court. SEC Brief at 40; SEC Reply Br. 15. Petitioners (appellees below), of course, sought affirmance of the district court's judgment of dismissal. Appellees' Brief at 35. It could not have been reasonably anticipated that the Fifth Circuit would render in part and remand in part — a result which both parties apparently find erroneous. *See* Br. 8-10.

of Appeals' opinion puts into issue, for any review granted by this Court, all elements required to support that finding, including, of course, the element of Petitioners' intent. *Aaron* v. *SEC*, — U.S. —, 100 S.Ct. 1945 (1980).

Therefore, Respondent's argument that Petitioners have not adequately preserved the issue of scienter for review by this Court, Br. 10, is without merit. Petitioners should not be penalized for not raising before the Court of Appeals' decision that which was not an issue until that decision. Only since the Fifth Circuit made the unanticipated disposition of this case it did on April 23, 1980, has the issue of scienter been relevant in its present form. Petitioners submit that their position is further strengthened by this Court's intervening decision in *Aaron, supra*, handed down on June 2, 1980.

3. The major portion of the SEC's Reply Brief is an attempt to justify the SEC's theory of materiality in this case, substantially adopted by the panel's opinion. Br. 10-13. Petitioners are prepared to show to this Court, if the Petition is granted, that the SEC's theory is not in accord with the great weight of authority, but is, instead, a novel odyssey in speculation.

Under the SEC's[4] theory, the Peterson proposal evidently became material[4] for disclosure purposes on the afternoon of May 13, 1975.[5]

[4] The SEC's theory as to the timing of materiality in this case suffers from fatal inconsistencies, as does the Fifth Circuit's determination of it. As noted in footnote 5 hereinbelow, the major thrust of the SEC's theory, as substantially adopted by the Court of Appeals, is to the effect that the Peterson proposal became material on May 13, 1975, the date on which Petitioner Mize was notified of the Crocker National Bank's tentative, preliminary action on the request for financing. However, there are also suggestions in the panel's opinion, at Pet. App. B-17, and in the SEC Brief, Br. 11, n. 10, that disclosure of the Peterson proposal should have been made even earlier, so that investors could decide whether to buy, sell or hold Southdown securities *prior to* May 13, 1975, which was also the record date of the Valhi spin-off. Thus, in its zeal to prosecute this case, the SEC is advancing the untenable contention that the idea being considered should have been disclosed before it became material. Indeed, it is unclear from the Court of Appeals' decision whether an idea such as

The evidence established — and was nowhere called into doubt either in the SEC's evidence or in the Court of Appeals' opinion — that the proposal was permanently abandoned *two days later*, on May 15, 1975. Though Petitioners vigorously dispute that the Peterson proposal ever became material[6] (therefore requiring public disclosure), even if the theory of the SEC and

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that embodied in the Valhi/NA/CP memorandum becomes material when it is first conceived, when it is first reduced to writing, when it is first discussed with interested parties, or when steps toward implementation are undertaken in preliminary fashion.

Petitioners submit that the materiality issue presented in this case is worthy of this Court's attention because, if the Fifth Circuit's obfuscated analysis of it is allowed to stand unreviewed, confusion will result. Consider the dilemma corporate managers and counsel face in making the decision concerning when an idea, such as the one contemplated in this case, should be disclosed to the investing public. If it is disclosed prematurely, the SEC will accuse them of attempting to promote the stock of their company. Yet from the facts of this case, the failure to disclose an idea which never passed the most embryonic stages of development has been held by the Court of Appeals to be a violation of the securities laws.

[5] It was on that date, in the view of the SEC and of the panel below, that the second of what the panel perceived as "the two principal hurdles," Pet. App. B-15, to implementation of the Valhi/NA/CP memorandum was "successfully surmounted," *id.*, by the California bank's tentative approval of Petitioners' request for financing. In the Court of Appeals' view, these two hurdles were "convincing Peterson of the merits of the deal and obtaining the necessary bank financing." *Id.* It is significant to note that to accept the conclusion that these two hurdles were ever overcome, one must completely ignore the undisputed evidence that (1) although Peterson indicated to Petitioner Mize his preliminary agreement with the proposal, he also made it abundantly clear that he would pursue *other* buyers for his National Alfalfa stock and that he and Mize had no "deal," and (2) bank financing was never "obtained" because the Bank never went beyond a mere preliminary approval of the financing application, subject to the provision that all other points in the Valhi/NA/CP memorandum be finalized. In sum, not only were the *two* hurdles perceived by the Court of Appeals never surmounted by Petitioners, but many *other* hurdles (as set out in the Valhi/NA/CP plan) were also never overcome — hence the failure and abandonment of the proposal.

[6] In this regard, Petitioners object to the Fifth Circuit's and the SEC's enshrinement of one line of testimony by Petitioner Mize at trial, quoted in the opinion at Pet. App. B-17 and by the SEC at Br. 6, as

the Court of Appeals is accepted as correct, the proposal was imbued with materiality in a legal sense for less than *two days*. Petitioners maintain that, even if the Peterson proposal did become legally material on May 13, 1975, it would have been physically impossible to have completed the actual mechanics of public disclosure (involving close work with attorneys,[7] printers and others) by May 15, 1975, the date on which the proposal was abandoned, never to be resurrected. Moreover, by the time of the Farnham counter tender-offer in late July, 1975, the Peterson proposal had been abandoned for over two months. And yet, because in the SEC's view that proposal had ripened

absolute, clear proof that the Valhi/NA/CP proposal would have been implemented but for the private litigation commenced on May 15, 1975. Petitioners would direct the Court's attention to the portions of Mize's testimony apparently ignored by the Fifth Circuit and by the SEC, which establish that the Valhi/NA/CP proposal never became anything more than an embryonic gleam in the eye:

Q: Now, Mr. Mize, when you and the McCarthys met with Mr. Peterson up there in Nebraska on April the 15th, 1975, did you and Mr. Peterson reach any agreement at that time whereby he agreed to sell his stock and you all agreed to buy it?

A: No.

* * *

Q: Would you please tell us, sir, after Crocker [National Bank] said that it would in all likelihood make the loan on May 13th, 1975, what else was yet to be done to accomplish the proposal that was set forth in that Valhi/NA/CP memorandum?

A: Well, as far as the Valhi was concerned, the lawyers had to function.

Q: What do you mean by that?

A: I mean they had to determine whether or not what we were purchasing was something that was legally acceptable and possible. After that was determined, the auditors, accountants, had to get into the picture. The thing had to be presented to the board. The board had to accept it. Then the documents, formal documents, had to be prepared. The contract would have to be negotiated with Mr. Peterson and his lawyer and the loan agreement would have to be prepared, which is no small matter.

[7] Although the attorneys for the company had been given a copy of the Valhi/NA/CP memorandum in April, 1975, they had been instructed to do no work on the transaction it described because there was so much uncertainty that a deal would ever be made.

into materiality within the meaning of the securities laws for a period of two days, the SEC contended, and the Court of Appeals agreed (Pet. App. at B-17), that the counter tender offer materials should have included disclosure of the prior matter, because under a hypertechnical reading of the cases construing the securities laws, it had been material for a period of two days, prior to its abandonment. Such a bizarre view of the materiality concept embodied in the securities laws is deserving of this Court's attention.

Furthermore, there is a serious misreading of the Court of Appeals' opinion in the SEC Reply Brief. At Br. 10-11, the SEC argues that the Fifth Circuit's determination of the materiality issue was correct because in this case reasonable minds could not differ as to the materiality of the allegedly undisclosed information. However, the panel's analysis of materiality cannot be defended on that basis.[8] The panel did *not* view the materiality issue in this case as being one on which reasonable minds could not differ. Indeed, its resolution of the issue illustrates the very negation of that view. It weighed the SEC's evidence on the issue of materiality, recognized that the evidence could support a finding either way on the issue and concluded "[W]e believe the balance in this case tips in favor of materiality." Pet. App. B.15.

Petitioners submit that the instant case presents an appropriate vehicle for the Court to remind the federal appellate courts of their proper, limited function in reviewing judgments in non-jury cases. When the Fifth Circuit panel below undertook to balance and tip the factual evidence presented, it usurped a

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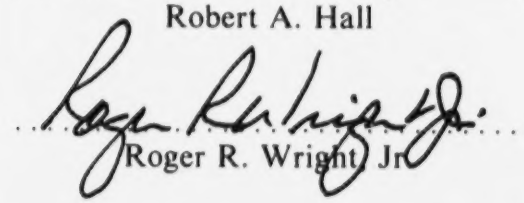
[8] In this connection, Petitioners also feel compelled to point out to the Court a blatant instance in the Reply Brief in which the SEC seriously misstates factual matters to bolster its theory of materiality. At Br. 5-6, the SEC states that the "negotiations concerning the Peterson proposal occurred contemporaneously with the consideration by Southdown directors of the spin-off of Valhi." The record, however, reveals contrary facts. Southdown directors' deliberation on the Valhi spin-off were concluded on March 27, 1975, when the board unanimously voted to approve the spin-off plan. The record shows that the Valhi/NA/CP memorandum was not prepared until April, 1975, and that Mize's first visit with Mr. Peterson to discuss the matter occurred on April 15, 1975.

function reserved by our jurisprudence to the trial court. In so doing, it not only spawned needless judicial diseconomy, it also dealt gross unfairness to Petitioners with its partial rendition of judgment against them and the tortured procedural posture it gave to the case.

Petitioners again pray for the relief sought in the Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, or alternatively, that the opinion below be vacated and the case be remanded to the Fifth Circuit for reconsideration in light of the concessions in Respondent's Brief.

Respectfully submitted,

Robert A. Hall



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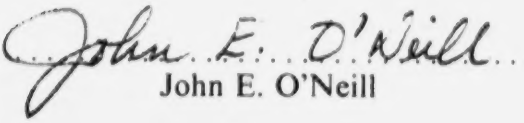

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CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of October, 1980, a true and correct copy of the above and foregoing Reply was served upon the Respondent's attorney of record by placing same in the United States mail, postage prepaid, sent certified mail, return receipt requested and addressed to Michael K. Wolensky, Associate General Counsel, and Douglas J. Scheidt, Attorney, Securities and Exchange Commission, 500 North Capitol Street, Washington, DC 20549, and upon Wade H. McCree, Jr., Solicitor General, Department of Justice, Washington, DC 20530.

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